
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 0-15279

GENERAL COMMUNICATION, INC.

(Exact name of registrant as specified in its charter)

STATE OF ALASKA

(State or other jurisdiction of
incorporation or organization)

92-0072737

(I.R.S. Employer
Identification No.)

2550 Denali Street
Suite 1000

Anchorage, Alaska

(Address of principal executive offices)

99503

(Zip Code)

Registrant's telephone number, including area code: (907) 868-5600

Former name, former address and former fiscal year, if changed since last report

Indicate by check mark whether the registrant (l) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes X No ____.

The number of shares outstanding of the registrant's classes of common stock as of October 28, 2004 was:

54,205,376 shares of Class A common stock; and
3,865,686 shares of Class B common stock.

GENERAL COMMUNICATION, INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2004

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Cautionary Statement Regarding Forward-Looking Statements

You should carefully review the information contained in this Quarterly Report, but should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (“SEC”). In this Quarterly Report, in addition to historical information, we state our future strategies, plans, objectives or goals and our beliefs of future events and of our future operating results, financial position and cash flows. In some cases, you can identify those so-called “forward-looking statements” by words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” “project,” or “continue” or the negative of those words and other comparable words. All forward-looking statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance, achievements, plans and objectives to differ materially from any future results, performance, achievements, plans and objectives expressed or implied by these forward-looking statements. In evaluating those statements, you should specifically consider various factors, including those outlined below. Those factors may cause our actual results to differ materially from any of our forward-looking statements. For these statements, we claim the protection of the safe harbor for forward-looking statements provided by The Private Securities Litigation Reform Act of 1995. Such risks, uncertainties and other factors include but are not limited to those identified below and those further described in *Part I, Item 1. Factors That May Affect Our Business and Future Results* of our annual report on Form 10-K for the year ended December 31, 2003.

- Material adverse changes in the economic conditions in the markets we serve and in general economic conditions, including the continuing impact of the following on the communications industry: high levels of competition in the long-distance market resulting in pressures to reduce prices; an oversupply of long-haul capacity; excessive debt loads; and several high-profile company failures and potentially fraudulent accounting practices by some companies;
- The efficacy of laws enacted by Congress and the State of Alaska legislature; rules and regulations to be adopted by the Federal Communications Commission (“FCC”) and state public regulatory agencies to implement the provisions of the Telecommunications Act of 1996 (“1996 Telecom Act”); the outcome of litigation relative thereto; and the impact of regulatory changes relating to access reform;
- Our responses to competitive products, services and pricing, including pricing pressures, technological developments, alternative routing developments, and the ability to offer combined service packages that include long-distance, local, cable, Internet, and wireless services;
- The extent and pace at which different competitive environments develop for each segment of our business;
- The extent and duration for which competitors from each segment of the communications industries are able to offer combined or full service packages prior to our being able to do so;
- The degree to which we experience material competitive impacts to our traditional service offerings prior to achieving adequate local service entry;
- Competitor responses to our products and services and overall market acceptance of such products and services;
- The outcome of our negotiations with Incumbent Local Exchange Carriers (“ILECs”) and state regulatory arbitrations and approvals with respect to interconnection agreements;

- Our ability to purchase network elements or wholesale services from ILECs at a price sufficient to permit the profitable offering of local telephone service at competitive rates;
- Success and market acceptance for new initiatives, many of which are untested;
- The level and timing of the growth and profitability of existing and new initiatives, particularly yellow page directories, local telephone services expansion including deploying digital local phone service (“DLPS”) and wireless services;
- Start-up costs associated with entering new markets, including advertising and promotional efforts;
- Risks relating to the operations of new systems and technologies and applications to support new initiatives;
- Local conditions and obstacles;
- The impact on our industry and indirectly on us of oversupply of capacity resulting from excessive deployment of network capacity in certain markets we do not serve;
- Uncertainties inherent in new business strategies, new product launches and development plans, including local telephone services, wireless services, and yellow page directories, and the offering of these services in geographic areas with which we are unfamiliar;
- The risks associated with technological requirements, technology substitution and changes and other technological developments;
- Prolonged service interruptions which could affect our business;
- Development and financing of communications, local telephone, wireless, Internet and cable networks and services;
- Future financial performance, including the availability, terms and deployment of capital; the impact of regulatory and competitive developments on capital outlays, and the ability to achieve cost savings and realize productivity improvements and the consequences of increased leverage;
- Availability of qualified personnel;
- Changes in, or failure, or inability, to comply with, government regulations, including, without limitation, regulations of the FCC, the Regulatory Commission of Alaska (“RCA”), the SEC, and adverse outcomes from regulatory proceedings;
- Changes in regulations governing unbundled network elements (“UNEs”);
- Uncertainties in federal military spending levels and military base closures in markets in which we operate;
- The ongoing global and domestic trend towards consolidation in the communications industry, which may result in our competitors being larger and better financed, and provide these competitors with extensive resources and greater geographic reach, allowing them to compete more effectively;
- Any continuing financial, credit and economic impacts of the MCI, Inc. (“MCI”) bankruptcy filing on the industry in general and on us in particular;
- The success of MCI's emergence from bankruptcy protection,
- A migration of MCI's or Sprint Corporation's (“Sprint”) traffic off our network without it being replaced by other common carriers that interconnect with our network;
- The effect on us of pricing pressures, new program offerings and market consolidation in the markets served by our significant customers, MCI and Sprint;
- The effect on us of industry consolidation including the potential acquisition of one or more of our large wholesale customers by a company with commercial relationships with other providers;
- Under Statement of Financial Accounting Standard (“SFAS”) No. 142, “Goodwill and Other Intangible Assets,” we must test our goodwill and other intangible assets with indefinite

lives for impairment at least annually. Under the SEC Staff Announcement Topic “Use of the Residual Method to Value Acquired Assets Other than Goodwill,” we must apply a direct value method to determine the fair value of our cable certificates for purposes of impairment testing no later than January 1, 2005. Impairment testing may result in a material, non-cash write-down of our cable certificate or goodwill assets and could have a material adverse impact on our results of operations; and

- Other risks detailed from time to time in our periodic reports filed with the SEC.

You should not place undue reliance on any such forward-looking statements. Further, any forward-looking statement, and such risks, uncertainties and other factors speak only as of the date on which they were originally made and we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect any change in our expectations with regard to those statements or any other change in events, conditions or circumstances on which any such statement is based, except as required by law. New factors emerge from time to time, and it is not possible for us to predict what factors will arise or when. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

PART I. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)	(Unaudited)	
ASSETS	September 30, 2004	December 31, 2003
Current assets:		
Cash and cash equivalents	\$ 8,769	10,435
Receivables	75,600	70,235
Less allowance for doubtful receivables	2,069	1,954
Net receivables	73,531	68,281
Prepaid and other current assets	6,743	12,159
Deferred income taxes, net	5,621	7,195
Inventories	2,555	1,513
Property held for sale	1,046	2,173
Notes receivable from related parties	354	1,885
Total current assets	98,619	103,641
Property and equipment in service, net of depreciation	421,128	369,039
Construction in progress	19,940	33,618
Net property and equipment	441,068	402,657
Cable certificates	191,241	191,241
Goodwill	41,972	41,972
Other intangible assets, net of amortization of \$2,087 and \$1,656 at September 30, 2004 and December 31, 2003, respectively	5,078	4,195
Deferred loan and senior notes costs, net of amortization of \$2,226 and \$5,308 at September 30, 2004 and December 31, 2003, respectively	9,102	5,757
Notes receivable from related parties	4,230	4,281
Other assets	9,315	9,276
Total other assets	260,938	256,722
Total assets	\$ 800,625	763,020

See accompanying notes to interim condensed consolidated financial statements.

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Continued)

(Amounts in thousands)	(Unaudited)	
LIABILITIES, REDEEMABLE PREFERRED STOCK, AND STOCKHOLDERS' EQUITY	September 30, 2004	December 31, 2003
<hr/>		
Current liabilities:		
Current maturities of obligations under capital leases	\$ 6,313	5,139
Accounts payable	27,350	34,133
Accrued payroll and payroll related obligations	14,025	17,545
Deferred revenue	13,844	21,275
Accrued liabilities	7,389	8,156
Accrued interest	2,860	8,645
Subscriber deposits	471	651
Total current liabilities	<hr/> 72,252	<hr/> 95,544
Long-term debt	377,060	345,000
Obligations under capital leases, excluding current maturities	34,244	38,959
Obligation under capital lease due to related party, excluding current maturity	680	677
Deferred income taxes, net of deferred income tax benefit	35,985	24,168
Other liabilities	6,811	6,366
Total liabilities	<hr/> 527,032	<hr/> 510,714
Redeemable preferred stock	<hr/> 19,244	<hr/> 25,664
Stockholders' equity:		
Common stock (no par):		
Class A. Authorized 100,000 shares; issued 54,139 and 52,589 shares at September 30, 2004 and December 31, 2003, respectively	211,012	202,362
Class B. Authorized 10,000 shares; issued 3,866 and 3,868 shares at September 30, 2004 and December 31, 2003, respectively; convertible on a share-per-share basis into Class A common stock	3,267	3,269
Less cost of 380 and 338 Class A common shares held in treasury at September 30, 2004 and December 31, 2003, respectively	(2,284)	(1,917)
Paid-in capital	13,617	12,836
Notes receivable with related parties issued upon stock option exercise	(4,351)	(4,971)
Retained earnings	33,088	15,371
Accumulated other comprehensive loss	---	(308)
Total stockholders' equity	<hr/> 254,349	<hr/> 226,642
Commitments and contingencies		
Total liabilities, redeemable preferred stock, and stockholders' equity	<hr/> <hr/> \$ 800,625	<hr/> <hr/> 763,020

See accompanying notes to interim condensed consolidated financial statements.

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Amounts in thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Revenues	\$ 106,622	98,327	319,324	287,043
Cost of goods sold (exclusive of depreciation, amortization and accretion shown separately below)	32,876	31,870	104,878	92,189
Selling, general and administrative expenses	37,324	35,262	108,830	102,549
Bad debt expense (recovery)	(281)	533	(1,165)	1,932
Depreciation, amortization and accretion expense	15,297	13,067	46,759	39,368
Operating income	21,406	17,595	60,022	51,005
Other income (expense):				
Interest expense	(6,722)	(8,845)	(20,275)	(27,137)
Loss on early extinguishment of debt	—	—	(6,136)	—
Amortization and write-off of loan and senior notes fees	(400)	(631)	(3,414)	(2,329)
Interest income	86	162	273	493
Other expense, net	(7,036)	(9,314)	(29,552)	(28,973)
Net income before income taxes and cumulative effect of a change in accounting principle	14,370	8,281	30,470	22,032
Income tax expense	5,075	3,752	11,525	9,598
Net income before cumulative effect of a change in accounting principle	9,295	4,529	18,945	12,434
Cumulative effect of a change in accounting principle, net of income tax benefit of \$367	—	—	—	(544)
Net income	\$ 9,295	4,529	18,945	11,890
Basic net income per common share:				
Net income before cumulative effect of a change in accounting principle	\$ 0.15	0.07	0.31	0.20
Cumulative effect of a change in accounting principle, net of income tax benefit of \$367	—	—	—	(0.01)
Net income	\$ 0.15	0.07	0.31	0.19
Diluted net income per common share:				
Net income before cumulative effect of a change in accounting principle	\$ 0.15	0.07	0.30	0.19
Cumulative effect of a change in accounting principle, net of income tax benefit of \$367	—	—	—	(0.01)
Net income	\$ 0.15	0.07	0.30	0.18

See accompanying notes to interim condensed consolidated financial statements.

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(Unaudited)

(Amounts in thousands)	Class A Common Stock	Class B Common Stock	Class A Shares Held in Treasury	Paid-in Capital	Notes Receivable Issued to Related Parties	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balances at December 31, 2002	\$199,903	3,274	(1,836)	11,222	(5,650)	1,847	(540)	208,220
Components of comprehensive income:								
Net income	--	--	--	--	--	11,890	--	11,890
Change in fair value of cash flow hedge, net of change in income tax liability of \$175	--	--	--	--	--	--	118	118
Comprehensive income								12,008
Tax effect of excess stock compensation expense for tax purposes over amounts recognized for financial reporting purposes	--	--	--	222	--	--	--	222
Shares issued under stock option plan	1,044	--	--	--	--	--	--	1,044
Amortization of the excess of GCI stock market value over stock option exercise cost on date of stock option grant	--	--	--	393	--	--	--	393
Class B shares converted to Class A	3	(3)	--	--	--	--	--	--
Purchase of treasury stock	--	--	(81)	--	--	--	--	(81)
Preferred stock dividends	--	--	--	--	--	(1,533)	--	(1,533)
Balances at September 30, 2003	<u>\$200,950</u>	<u>3,271</u>	<u>(1,917)</u>	<u>11,837</u>	<u>(5,650)</u>	<u>12,204</u>	<u>(422)</u>	<u>220,273</u>

See accompanying notes to interim condensed consolidated financial statements.

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(Unaudited)
(Continued)

(Amounts in thousands)	Class A Common Stock	Class B Common Stock	Class A Shares Held in Treasury	Paid-in Capital	Notes Receivable Issued to Related Parties	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balances at December 31, 2003	\$202,362	3,269	(1,917)	12,836	(4,971)	15,371	(308)	226,642
Components of comprehensive income:								
Net income	---	---	---	---	---	18,945	---	18,945
Change in fair value of cash flow hedge, net of change in income tax benefit of \$207	---	---	---	---	---	---	308	308
Comprehensive income								19,253
Tax effect of excess stock compensation expense for tax purposes over amounts recognized for financial reporting purposes	---	---	---	534	---	---	---	534
Class B shares converted to Class A	2	(2)	---	---	---	---	---	---
Shares issued under stock option plan	2,228	---	---	---	---	---	---	2,228
Amortization of the excess of GCI stock market value over stock option exercise cost on date of stock option grant	---	---	---	247	---	---	---	247
Conversion of Series B preferred stock to Class A common stock	6,420	---	---	---	---	---	---	6,420
Payments received on notes receivable issued to related parties upon stock option exercise	---	---	---	---	620	---	---	620
Purchase of treasury stock	---	---	(367)	---	---	---	---	(367)
Preferred stock dividends	---	---	---	---	---	(1,228)	---	(1,228)
Balances at September 30, 2004	<u>\$211,012</u>	<u>3,267</u>	<u>(2,284)</u>	<u>13,617</u>	<u>(4,351)</u>	<u>33,088</u>	<u>---</u>	<u>254,349</u>

See accompanying notes to interim condensed consolidated financial statements.

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(Unaudited)

(Amounts in thousands)	2004	2003
Cash flows from operating activities:		
Net income	\$ 18,945	11,890
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion expense	46,759	39,368
Loss on early extinguishment of debt	6,136	—
Deferred income tax expense	11,435	9,598
Amortization and write-off of loan and senior notes fees	3,414	2,329
Compensatory stock options	248	393
Bad debt expense (recovery), net of write-offs	115	(679)
Deferred compensation	427	331
Cumulative effect of a change in accounting principle, net	—	544
Other noncash income and expense items	654	(383)
Change in operating assets and liabilities	(25,267)	(13,990)
Net cash provided by operating activities	62,866	49,401
Cash flows from investing activities:		
Purchases of property and equipment, including construction period interest	(82,810)	(34,393)
Purchases of other assets and intangible assets	(2,297)	(955)
Payments received on notes receivable from related parties	1,847	22
Proceeds from sales of assets	1,190	—
Payment of deposits	—	(3,221)
Refund of deposit	699	—
Additions to property held for sale	(128)	—
Notes receivable issued to related parties	(27)	(99)
Net cash used in investing activities	(81,526)	(38,646)
Cash flows from financing activities:		
Issuance of new Senior Notes	245,720	—
Repayment of old Senior Notes	(180,000)	—
Borrowing on Senior Credit Facility	20,000	—
Repayment of Senior Credit Facility	(53,832)	(7,700)
Repayments of capital lease obligations	(3,538)	(1,402)
Payment of debt issuance costs	(6,659)	(2,605)
Payment of bond call premiums	(6,136)	—
Payment of preferred stock dividends	(1,042)	(1,171)
Proceeds from common stock issuance	2,228	1,044
Payment received on note receivable from related parties issued upon stock option exercise	620	—
Purchase of treasury stock	(367)	(81)
Net cash provided by (used in) financing activities	16,994	(11,915)
Net decrease in cash and cash equivalents	(1,666)	(1,160)
Cash and cash equivalents at beginning of period	10,435	11,940
Cash and cash equivalents at end of period	\$ 8,769	10,780

See accompanying notes to interim condensed consolidated financial statements.

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
Notes to Interim Condensed Consolidated Financial Statements
(Unaudited)

The accompanying unaudited interim condensed consolidated financial statements include the accounts of General Communication, Inc. ("GCI") and its subsidiaries and have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. They should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2003, filed as part of our annual report on Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for interim periods are not necessarily indicative of the results that may be expected for an entire year or any other period.

(l) Business and Summary of Significant Accounting Principles

In the following discussion, GCI and its direct and indirect subsidiaries are referred to as "we," "us" and "our."

(a) Business

GCI, an Alaska corporation, was incorporated in 1979. We offer the following services:

- Long-distance telephone service between Alaska and the remaining United States and foreign countries,
- Cable television services throughout Alaska,
- Facilities-based competitive local access services in Anchorage, Fairbanks, and Juneau, Alaska,
- Internet access services,
- Origination and termination of traffic in Alaska for certain common carriers,
- Private line and private network services,
- Managed services to certain commercial customers,
- Broadband services, including our SchoolAccess™ offering to rural school districts and a similar offering to rural hospitals and health clinics,
- Sales and service of dedicated communications systems and related equipment,
- Lease and sales of capacity on our undersea fiber optic cable system used in the transmission of interstate and intrastate private line, switched message long-distance and Internet services between Alaska and the remaining United States and foreign countries, and
- Distribution of white and yellow pages directories to residential and business customers in certain markets we serve and on-line directory products.

(b) Principles of Consolidation

The consolidated financial statements include the consolidated accounts of GCI and its wholly owned subsidiaries with all significant intercompany transactions eliminated.

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
Notes to Interim Condensed Consolidated Financial Statements
(Unaudited)

(c) Earnings per Common Share

Earnings per common share ("EPS") and common shares used to calculate basic and diluted EPS consist of the following (amounts in thousands, except per share amounts):

	Three Months Ended September 30,					
	2004			2003		
	Income (Num- erator)	Shares (Denom- inator)	Per-share Amounts	Income (Num- erator)	Shares (Denom- inator)	Per-share Amounts
Net income	<u>\$ 9,295</u>			<u>\$ 4,529</u>		
Less preferred stock dividends:						
Series B	230			361		
Series C	<u>151</u>			<u>151</u>		
	<u>381</u>			<u>512</u>		
Basic EPS:						
Net income	8,914	58,031	\$ 0.15	4,017	55,707	\$ 0.07
Effect of Dilutive Securities:						
Unexercised stock options	--	1,000	--	--	1,163	--
Series B redeemable preferred stock	<u>230</u>	<u>1,677</u>	---	---	---	---
Diluted EPS:						
Net income	<u>\$ 9,144</u>	<u>60,708</u>	<u>\$ 0.15</u>	<u>\$ 4,017</u>	<u>56,870</u>	<u>\$ 0.07</u>

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
Notes to Interim Condensed Consolidated Financial Statements
(Unaudited)

	Nine Months Ended September 30,					
	2004			2003		
	Income (Num- erator)	Shares (Denom- inator)	Per-share Amounts	Income (Num- erator)	Shares (Denom- inator)	Per-share Amounts
Net income before cumulative effect of a change in accounting principle, net of deferred tax benefit of \$367 in 2003	<u>\$ 18,945</u>			<u>\$ 12,434</u>		
Less preferred stock dividends:						
Series B	778			1,083		
Series C	450			450		
	<u>1,228</u>			<u>1,533</u>		
Basic EPS:						
Net income before cumulative effect of a change in accounting principle, net of deferred tax benefit of \$367 in 2003, available to common stockholders	17,717	57,027	\$ 0.31	10,901	55,563	\$ 0.20
Effect of Dilutive Securities:						
Unexercised stock options	---	1,135	---	---	531	---
Diluted EPS:						
Net income before cumulative effect of a change in accounting principle, net of deferred tax benefit of \$367 in 2003, available to common stockholders	<u>\$ 17,717</u>	<u>58,162</u>	<u>\$ 0.30</u>	<u>\$ 10,901</u>	<u>56,094</u>	<u>\$ 0.19</u>

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
Notes to Interim Condensed Consolidated Financial Statements
(Unaudited)

Common equivalent shares outstanding which are anti-dilutive for purposes of calculating EPS for the three and nine months ended September 30, 2004 and 2003 are not included in the diluted EPS calculations and consist of the following (shares, in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
Series B redeemable preferred stock	—	3,062	1,677	3,062
Series C redeemable preferred stock	833	833	833	833
Anti-dilutive common equivalent shares outstanding	<u>833</u>	<u>3,895</u>	<u>2,510</u>	<u>3,895</u>

Weighted average shares associated with outstanding stock options for the three and nine months ended September 30, 2004 and 2003 which have been excluded from the diluted EPS calculations because the options' exercise price was greater than the average market price of the common shares consist of the following (shares, in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
Weighted average shares associated with outstanding stock options	<u>736</u>	<u>155</u>	<u>292</u>	<u>2,045</u>

(d) Common Stock

Following are the changes in common stock for the nine months ended September 30, 2004 and 2003 (shares, in thousands):

	Class A	Class B
Balances at December 31, 2002	51,795	3,875
Class B shares converted to Class A	4	(4)
Shares issued under stock option plan	216	—
Shares issued per G.C. Cablevision, Inc. acquisition agreement	223	—
Balances at September 30, 2003	<u>52,238</u>	<u>3,871</u>
Balances at December 31, 2003	52,589	3,868
Class B shares converted to Class A	2	(2)
Shares issued under stock option plan	388	—
Conversion of Series B preferred stock to Class A common stock	1,160	—
Balances at September 30, 2004	<u>54,139</u>	<u>3,866</u>

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
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(e) Redeemable Preferred Stocks

Redeemable preferred stocks consist of the following (amounts in thousands):

	September 30, 2004	December 31, 2003
Series B	\$ 9,244	15,664
Series C	10,000	10,000
	<u>\$ 19,244</u>	<u>25,664</u>

We have 1,000,000 shares of preferred stock authorized with the following shares issued (in thousands):

	<u>Series B</u>	<u>Series C</u>
Shares at December 31, 2002 and September 30, 2003	<u>17</u>	<u>10</u>
Shares at December 31, 2003	16	10
Shares converted to GCI Class A common stock	<u>(7)</u>	<u>---</u>
Shares at September 30, 2004	<u><u>9</u></u>	<u><u>10</u></u>

As of September 30, 2004, the combined aggregate amount of preferred stock mandatory redemption requirements, including dividends, follow (amounts in thousands):

Years Ending September 30:	
2005	\$ 10,150
2006	---
2007	---
2008	---
2009	---
	<u>\$ 10,150</u>

Series B

The redemption amount of our Series B preferred stock at September 30, 2004 and December 31, 2003 was \$9,653,000 and \$15,887,000, respectively. The difference between the carrying and redemption amounts is due to accrued dividends that are included in Accrued Liabilities.

Series C

The redemption amount of our convertible redeemable accreting Series C preferred stock on September 30, 2004 and December 31, 2003 was \$10,000,000.

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(f) Asset Retirement Obligations

Upon adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations," we recorded the cumulative effect of accretion and depreciation expense as a cumulative effect of a change in accounting principle of approximately \$544,000, net of income tax benefit of \$367,000, during the nine months ended September 30, 2003.

Following is a reconciliation of the beginning and ending aggregate carrying amount of our asset retirement obligations at September 30, 2004 and 2003 (amounts in thousands):

Balance at December 31, 2002	\$ ---
Liability recognized upon adoption of SFAS No. 143	1,565
Accretion expense for the nine months ended September 30, 2003	96
Balance at September 30, 2003	<u>\$ 1,661</u>
Balance at December 31, 2003	\$ 2,005
Accretion expense for the nine months ended September 30, 2004	134
Liability settled	(6)
Other	(43)
Balance at September 30, 2004	<u>\$ 2,090</u>

(g) Stock Option Plan

At September 30, 2004, we had one stock-based employee compensation plan. We account for this plan under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. We use the intrinsic-value method and compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. We have adopted SFAS No. 123, "Accounting for Stock-Based Compensation," and SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." We have elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure as required by SFAS No. 148.

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Stock-based employee compensation cost is reflected over the options' vesting period of generally five years and compensation cost for options granted prior to January 1, 1996 is not considered. The following table illustrates the effect on net income and EPS for the three and nine months ended September 30, 2004 and 2003, if we had applied the fair-value recognition provisions of SFAS No. 123 to stock-based employee compensation (amounts in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income, as reported	\$ 9,295	4,529	18,945	11,890
Total stock-based employee compensation expense included in reported net income, net of related tax effects	53	66	129	225
Total stock-based employee compensation expense under the fair-value based method for all awards, net of related tax effects	(594)	(653)	(1,682)	(1,641)
Pro forma net income	<u>\$ 8,754</u>	<u>3,942</u>	<u>17,392</u>	<u>10,474</u>
Basic net income per common share after cumulative effect of a change in accounting principle, as reported	<u>\$ 0.15</u>	<u>0.07</u>	<u>0.31</u>	<u>0.19</u>
Diluted net income per common share after cumulative effect of a change in accounting principle, as reported	<u>\$ 0.15</u>	<u>0.07</u>	<u>0.30</u>	<u>0.18</u>
Basic and diluted net income per common share after cumulative effect of a change in accounting principle, pro forma	<u>\$ 0.14</u>	<u>0.06</u>	<u>0.28</u>	<u>0.16</u>

The calculation of total stock-based employee compensation expense under the fair-value based method includes weighted-average assumptions of a risk-free interest rate, volatility and an expected life.

(h) Variable Interest Entities

In December 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. ("FIN") 46 (revised December 2003), "Consolidation of Variable Interest

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Entities,” which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R, which was issued in January 2003, replaces FIN 46. We were required to apply FIN 46R to variable interests in Variable Interest Entities (“VIEs”) created after December 31, 2003. For variable interests in VIEs created before January 1, 2004, the Interpretation will be applied beginning on January 1, 2005. For any VIEs that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and non-controlling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and non-controlling interest of the VIE. At December 31, 2003, we did not have VIEs. Adoption of this statement on January 1, 2004 did not have a material effect on our results of operations, financial position and cash flows.

(i) Use of the Residual Method to Value Acquired Assets Other than Goodwill

On September 29, 2004, the SEC issued SEC Staff Announcement Topic “Use of the Residual Method to Value Acquired Assets Other than Goodwill,” (“SEC Staff Announcement”) requiring us to apply no later than January 1, 2005 a direct value method to determine the fair value of our intangible assets with indefinite lives other than goodwill for purposes of impairment testing. We must also recognize previously unrecognized intangible assets, if any, in the determination of fair value for impairment testing purposes. Our cable certificate assets are our only indefinite-lived assets other than goodwill as of September 30, 2004. Our cable certificate assets were originally valued and recorded using the residual method. Impairment testing of our cable certificate assets in future periods under SFAS No. 142 must use a direct value method pursuant to the SEC Staff Announcement, which may result in a material, non-cash write-down of our cable certificate assets and could have a material adverse impact on our results of operations. An impairment of our cable certificate assets, if any, recognized upon the initial application of the direct value method will be reported as a cumulative effect of a change in accounting principle.

(j) Reclassifications

Reclassifications have been made to the 2003 financial statements to make them comparable with the 2004 presentation.

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(2) Consolidated Statements of Cash Flows Supplemental Disclosures

Changes in operating assets and liabilities consist of (amounts in thousands):

Nine month periods ended September 30,	2004	2003
Increase in accounts receivable	\$ (5,365)	(9,315)
Increase in inventories	(1,042)	(137)
(Increase) decrease in prepaid and other current assets	5,416	(2,434)
Decrease in accounts payable	(6,783)	(2,802)
Increase (decrease) in deferred revenues	(7,431)	2,211
Increase (decrease) in accrued payroll and payroll related obligations	(3,520)	3,745
Decrease in accrued interest	(5,785)	(4,977)
Increase (decrease) in accrued liabilities	(252)	136
Decrease in subscriber deposits	(180)	(198)
Decrease in components of other long-term liabilities	(325)	(219)
	\$ (25,267)	(13,990)

We paid interest, including capitalized interest, totaling approximately \$27.1 million and \$32.2 million during the nine months ended September 30, 2004 and 2003, respectively. We capitalized interest of approximately \$1.1 million and \$0 during the nine months ended September 30, 2004 and 2003, respectively. Capitalized interest is recorded as an addition to Property and Equipment.

In January and August 2004, 3,108 and 3,328 shares of our Series B preferred stock, respectively, were converted to 560,000 and 599,640 shares of our Class A common stock, respectively, at the stated conversion price of \$5.55 per share.

We paid income taxes totaling \$90,000 during the nine months ended September 30, 2004. We paid no income taxes during the nine months ended September 30, 2003.

(3) Intangible Assets

Cable certificates are allocated to our cable services segment. Goodwill of approximately \$41.0 million is allocated to the cable services segment and approximately \$1.0 million is allocated to the long-distance services segment.

Amortization expense for amortizable intangible assets was as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
Amortization expense	\$ 224	195	575	527

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Amortization expense for amortizable intangible assets for each of the five succeeding fiscal years is estimated to be (amounts in thousands):

Years Ending December 31,	
2004	\$ 826
2005	806
2006	802
2007	740
2008	490

No indicators of impairment have occurred since the impairment testing was performed as of December 31, 2003.

(4) MCI Settlement and Release Agreement

On July 21, 2002 MCI and substantially all of its active United States subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court. On July 22, 2003, the United States Bankruptcy Court approved a settlement agreement for pre-petition amounts owed to us by MCI and affirmed all of our existing contracts with MCI. MCI emerged from bankruptcy protection on April 20, 2004. The remaining pre-petition accounts receivable balance owed by MCI to us after this settlement was \$11.1 million ("MCI credit") which we have used and will continue to use as a credit against amounts payable for services purchased from MCI.

After settlement, we began reducing the MCI credit as we utilized it for services otherwise payable to MCI. Uncertainties exist with respect to the potential realization and the timing of our utilization of the MCI credit. We have accounted for our use of the MCI credit as a gain contingency and, accordingly, will recognize a reduction of bad debt expense as services are provided by MCI and the credit is realized. The use of the credit is recorded as a reduction of bad debt expense. We have realized the following amounts of the MCI credit against amounts payable for services received from MCI (amounts in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
MCI credit realized	<u>\$ 1,090</u>	<u>647</u>	<u>3,386</u>	<u>647</u>

The remaining unused MCI credit totaled \$4.5 million and \$7.9 million at September 30, 2004 and December 31, 2003, respectively. The credit balance is not recorded on the Consolidated Balance Sheet as we are recognizing recovery of bad debt expense as the credit is realized.

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(5) Long-term Debt

Draws on New Senior Credit Facility

In 2004 we drew the following amounts under the revolving credit portion of our new Senior Credit Facility (amounts in millions):

January 2004	\$ 10
May 2004	5
August 2004	<u>5</u>
	<u>\$ 20</u>

We re-paid the \$10 million draw in February 2004 from proceeds of our new Senior Notes offering discussed below.

Senior Notes Refinancing

In February 2004 GCI's wholly owned subsidiary GCI, Inc. sold \$250 million in aggregate principal amount of senior debt securities due in 2014 ("new Senior Notes"). The new Senior Notes are an unsecured senior obligation. We pay interest of 7.25% on the new Senior Notes. The new Senior Notes were sold at a discount of \$4.3 million. The Senior Notes are carried on our Consolidated Balance Sheet net of the unamortized portion of the discount of \$4.1 million at September 30, 2004, which is being amortized to Interest Expense over the life of the new Senior Notes.

The net proceeds of the offering were primarily used to repay our existing \$180.0 million 9.75% Senior Notes ("old Senior Notes") and to repay approximately \$43.8 million of the term portion and \$10.0 million of the revolving portion of our new Senior Credit Facility. A semi-annual interest payment of approximately \$9.1 million was paid on August 15, 2004. The next semi-annual interest payment will be due on February 15, 2005. In connection with the issuance, we paid fees and other expenses of approximately \$6.4 million which are being amortized over the life of the new Senior Notes.

The new Senior Notes sold in February 2004 were offered only to qualified institutional buyers pursuant to exemptions from registration under the Securities Act. On July 7, 2004, GCI, Inc. commenced an offer to exchange the privately issued new Senior Notes for a like amount of new Senior Notes that have been registered under the Securities Act and have otherwise identical terms to the privately issued new Senior Notes (except for provisions relating to GCI, Inc.'s obligations to consummate the exchange offer). The exchange offer closing occurred on August 11, 2004, at which time all \$250.0 million in aggregate principal amount of the privately issued new Senior Notes were tendered and exchanged for the new Senior Notes that have been registered under the Securities Act.

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The new Senior Notes are not redeemable prior to February 15, 2009. At any time on or after February 15, 2009, the new Senior Notes are redeemable at our option, in whole or in part, on not less than thirty days nor more than sixty days notice, at the following redemption prices, plus accrued and unpaid interest (if any) to the date of redemption:

If redeemed during the twelve month period commencing February 1 of the year indicated:	Redemption Price
2009	103.625%
2010	102.417%
2011	101.208%
2012 and thereafter	100.000%

We may, on or prior to February 17, 2007, at our option, use the net cash proceeds of one or more underwritten public offerings of our qualified stock to redeem up to a maximum of 35% of the initially outstanding aggregate principal amount of our new Senior Notes at a redemption price equal to 107.25% of the principal amount of the new Senior Notes, together with accrued and unpaid interest, if any, thereon to the date of redemption, provided that not less than 65% of the principal amount of the new Senior Notes originally issued remain outstanding following such a redemption.

The new Senior Notes restrict GCI, Inc. and certain of its subsidiaries from incurring debt in most circumstances unless the result of incurring debt does not cause our leverage ratio to exceed 6.0 to one. The new Senior Notes do not allow debt under the new Senior Credit Facility to exceed the greater of (and reduced by certain stated items):

- \$250 million, reduced by the amount of any prepayments, or
- 3.0 times earnings before interest, taxes, depreciation, and amortization for the last four full fiscal quarters of GCI, Inc. and certain of its subsidiaries.

The new Senior Notes limit our ability to make cash dividend payments.

We conducted a Consent Solicitation and Tender Offer for the old Senior Notes. Through February 13, 2004 we accepted for payment \$114.6 million principal amount of notes which were validly tendered. Such notes accepted for payment received additional consideration as follows:

- \$4.0 million based upon a payment of \$1,035 per \$1,000 principal amount, consisting of the purchase price of \$1,025 per \$1,000 principal amount and the consent payment of \$10 per \$1,000 principal amount, and
- \$497,000 in accrued and unpaid interest through February 16, 2004.

The remaining principal amount of \$65.4 million was redeemed on March 18, 2004 for additional consideration as follows:

- \$2.1 million based upon a payment of \$1,032.50 per \$1,000 principal amount, and
- \$833,000 in accrued and unpaid interest through March 18, 2004.

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The total redemption cost was \$186.1 million. The premium to redeem our old Senior Notes was \$6.1 million (excluding interest cost of \$1.3 million) and was recognized as a loss on early extinguishment of debt, a component of Other Income (Expense), during the nine months ended September 30, 2004.

Compliance with the redemption notice requirements in the Indenture resulted in a delay before final payment of some of the old Senior Notes. As a result of such delay, our total debt increased during the overlap period between the redemption of the old Senior Notes and the issuance of the new Senior Notes making us out of compliance with Section 6.11 of our Credit, Guaranty, Security and Pledge Agreement, dated as of October 30, 2003. We received a waiver from compliance with Section 6.11 until April 30, 2004. After the final redemption payment on March 18, 2004 we were in compliance with Section 6.11.

New Senior Credit Facility Amendment

On May 21, 2004 we amended our \$220.0 million new Senior Credit Facility. The amendment reduced the interest rate on the \$170.0 million term portion of the credit facility from LIBOR plus 3.25% to LIBOR plus 2.25%. The amendment reduced the interest rate on the \$50.0 million revolving portion of the credit facility from LIBOR plus 3.25% to LIBOR plus a margin dependent upon our Total Leverage Ratio (as defined) as follows:

<u>Total Leverage Ratio (as defined)</u>	<u>LIBOR Plus:</u>
≥3.75	2.50%
≥3.25 but <3.75	2.25%
≥2.75 but <3.25	2.00%
< 2.75	1.75%

The commitment fee we are required to pay on the unused portion of the commitment was amended as follows:

<u>Total Leverage Ratio (as defined)</u>	<u>Commitment Fee</u>
≥3.75	0.625%
≥2.75 but <3.75	0.500%
< 2.75	0.375%

Under certain circumstances the amendment allows for an increase in the term and revolving commitments not to exceed an aggregate commitment increase of \$50.0 million. Any additional term and revolving credit facility commitments are payable in full on October 31, 2007.

In connection with the May 21, 2004 amended Senior Credit Facility, we paid bank fees and other expenses of approximately \$103,000 and \$253,000 during the three and nine months ended September 30, 2004, respectively.

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(6) Industry Segments Data

Our reportable segments are business units that offer different products. The reportable segments are each managed separately and offer distinct products with different production and delivery processes.

We have four reportable segments as follows:

Long-distance services. We offer a full range of common carrier long-distance services to commercial, government, other telecommunications companies and residential customers, through our networks of fiber optic cables, digital microwave, and fixed and transportable satellite earth stations and our SchoolAccess™ offering to rural school districts and a similar offering to rural hospitals and health clinics.

Cable services. We provide cable television services to residential, commercial and government users in the State of Alaska. Our cable systems serve 35 communities and areas in Alaska, including the state's four largest urban areas, Anchorage, Fairbanks, the Matanuska-Susitna Valley, and Juneau. We offer digital cable television services in Anchorage, the Matanuska-Susitna Valley, Fairbanks, Juneau, Ketchikan, Kenai, Soldotna, Kodiak, Seward, Cordova, Valdez, and Nome and retail cable modem service (through our Internet services segment) in all of our locations in Alaska except Kotzebue.

Local access services. We offer facilities based competitive local exchange services in Anchorage, Fairbanks and Juneau and plan to provide similar competitive local exchange services in other locations pending regulatory approval and subject to availability of capital. Revenue, costs of sales and service and operating expenses for our new phone directories are included in the local access services segment.

Internet services. We offer wholesale and retail Internet services to both consumer and commercial customers. We offer cable modem service as further described in Cable services above. Our undersea fiber optic cable systems allow us to offer enhanced services with high-bandwidth requirements.

Included in the "All Other" category in the tables that follow are our managed services, product sales and cellular telephone services. None of these business units has ever met the quantitative thresholds for determining reportable segments. Also included in the All Other category are corporate related expenses including information technology, accounting, legal and regulatory, human resources, and other general and administrative expenses.

We evaluate performance and allocate resources based on (1) earnings or loss from operations before depreciation, amortization and accretion expense, net other expense and income taxes, and (2) operating income or loss. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in note 1. Intersegment sales are recorded at cost plus an agreed upon intercompany profit.

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We earn all revenues through sales of services and products within the United States. All of our long-lived assets are located within the United States of America, except approximately 82% of our undersea fiber optic cable systems which transit international waters.

Summarized financial information for our reportable segments for the nine months ended September 30, 2004 and 2003 follows (amounts in thousands):

	Reportable Segments						
	Long-Distance Services	Cable Services	Local Access Services	Internet Services	Total Reportable Segments	All Other	Total
<u>2004</u>							
Revenues:							
Intersegment	\$ 10,490	1,866	7,053	2,460	21,869	558	22,427
External	159,111	75,243	34,558	19,592	288,504	30,820	319,324
Total revenues	<u>\$169,601</u>	<u>77,109</u>	<u>41,611</u>	<u>22,052</u>	<u>310,373</u>	<u>31,378</u>	<u>341,751</u>
Earnings (loss) from operations before depreciation, amortization, accretion, net interest expense and income taxes	\$ 91,010	33,190	(231)	6,409	130,378	(23,597)	106,781
Operating income (loss)	<u>\$ 71,368</u>	<u>19,118</u>	<u>(3,158)</u>	<u>3,669</u>	<u>90,997</u>	<u>(30,975)</u>	<u>60,022</u>
<u>2003</u>							
Revenues:							
Intersegment	\$ 10,139	1,900	7,277	1,792	21,108	558	21,666
External	153,248	71,009	27,211	14,302	265,770	21,273	287,043
Total revenues	<u>\$163,387</u>	<u>72,909</u>	<u>34,488</u>	<u>16,094</u>	<u>286,878</u>	<u>21,831</u>	<u>308,709</u>
Earnings (loss) from operations before depreciation, amortization, accretion, net interest expense and income taxes	\$ 85,212	31,253	(3,182)	3,667	116,950	(26,577)	90,373
Operating income (loss)	<u>\$ 70,629</u>	<u>17,812</u>	<u>(5,794)</u>	<u>1,138</u>	<u>83,785</u>	<u>(32,780)</u>	<u>51,005</u>

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A reconciliation of reportable segment revenues to consolidated revenues follows (amounts in thousands):

Nine months ended September 30,	2004	2003
Reportable segment revenues	\$ 310,373	286,878
Plus All Other revenues	31,378	21,831
Less intersegment revenues eliminated in consolidation	22,427	21,666
Consolidated revenues	\$ 319,324	287,043

A reconciliation of reportable segment earnings from operations before depreciation, amortization and accretion expense, net other expense and income taxes to consolidated net income before income taxes and cumulative effect of a change in accounting principle follows (amounts in thousands):

Nine months ended September 30,	2004	2003
Reportable segment earnings from operations before depreciation, amortization and accretion expense, net other expense and income taxes	\$ 130,378	116,950
Less All Other loss from operations before depreciation, amortization and accretion expense, net other expense and income taxes	23,597	26,577
Consolidated earnings from operations before depreciation, amortization and accretion expense, net other expense and income taxes	106,781	90,373
Less depreciation, amortization and accretion expense	46,759	39,368
Consolidated operating income	60,022	51,005
Less other expense, net	29,552	28,973
Consolidated net income before income taxes and cumulative effect of a change in accounting principle	\$ 30,470	22,032

A reconciliation of reportable segment operating income to consolidated net income before income taxes and cumulative effect of a change in accounting principle follows (amounts in thousands):

Nine months ended September 30,	2004	2003
Reportable segment operating income	\$ 90,997	83,785
Less All Other operating loss	30,975	32,780
Consolidated operating income	60,022	51,005
Less other expense, net	29,552	28,973
Consolidated net income before income taxes and cumulative effect of a change in accounting principle	\$ 30,470	22,032

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(7) Commitments and Contingencies

Litigation and Disputes

We are routinely involved in various lawsuits, billing disputes, legal proceedings, and regulatory matters that have arisen in the normal course of business. While the ultimate results of these items cannot be predicted with certainty we do not expect at this time the resolution of them to have a material adverse effect on our financial position, results of operations or liquidity.

Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others

Certain customers have guaranteed levels of service. In the event we are unable to provide the minimum service levels we may incur penalties or issue credits to customers.

Fiber Optic Cable System Construction Commitment

In June 2003 we began work on the construction of a fiber optic cable system connecting Seward, Alaska and Warrenton, Oregon, with leased backhaul facilities to connect it to our switching and distribution centers in Anchorage, Alaska and Seattle, Washington ("AULP West"). A consortium of companies was selected to design, engineer, manufacture, and install the undersea fiber optic cable system and a contract was signed at a total cost to us of \$35.2 million. In July 2004 we made our final payment on the contract.

From inception through September 30, 2004 our capital expenditures for this project have totaled approximately \$50.1 million, most of which was funded through our operating cash flows. We placed AULP West into service in June 2004.

Fiber Optic Cable System Repair

Our undersea fiber optic cable system connecting Whittier, Valdez and Juneau, Alaska and Seattle, Washington ("AULP East") experienced powering irregularities during the first quarter of 2004. We completed the repair of AULP East in July 2004 and recorded an estimate of the total repair costs of approximately \$400,000.

Internal Revenue Service Examination

Our United States income tax return for 2000 was selected for examination by the Internal Revenue Service during 2003. The examination was completed in July 2004 and did not have a material adverse effect on our financial position, results of operations, or our liquidity.

Our United States income tax return for 2001 was selected for examination by the Internal Revenue Service during 2004. The examination began during the second quarter of 2004. We believe this examination will not have a material adverse effect on our financial position, results of operations, or our liquidity.

Anchorage UNEs Arbitration

In June 2004 the RCA issued an order in our arbitration to revise the rates, terms, and conditions that govern our access to UNEs in Anchorage. The RCA's ruling set rates for numerous elements of Alaska Communications Systems Group, Inc.'s ("ACS") network, the most significant being the lease rate for local lines. The order increases the lease rate from \$14.92 to \$18.64 per line per month. We estimate the ruling will increase our local access services segment Cost of Goods Sold

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(exclusive of depreciation, amortization and accretion shown separately) by as much as approximately \$1.7 million and \$4.1 million during the years ended December 31, 2004 and 2005, respectively. We have filed a petition for reconsideration with the RCA. We cannot predict at this time the outcome of the petition for reconsideration.

We and ACS have jointly filed an Anchorage Interconnection Agreement and are awaiting approval from the RCA. The agreement, if approved, will have a five-year term.

Rural Exemption

ACS, through subsidiary companies, provides local services in Fairbanks and Juneau, Alaska. These ACS subsidiaries are classified as Rural Telephone Companies under the 1996 Telecom Act, which entitles them to an exemption of certain material interconnection terms of the 1996 Telecom Act, until and unless such "rural exemption" is examined and discontinued by the RCA. An April 2004 proceeding to decide the matter of rural exemption was canceled upon our and ACS' joint settlement. The settlement agreement includes the following terms, among others:

- ACS relinquishes all claims to exemptions from full local telephone competition in Fairbanks and Juneau,
- New rates for unbundled loops in Fairbanks and Juneau will begin January 1, 2005. We estimate the agreed upon rates will increase our local services segment cost of sales and service approximately \$600,000 to \$700,000 during the year ended December 31, 2005,
- Extension of existing interconnection agreements between ACS and us for Fairbanks and Juneau until January 1, 2008, and
- Resolution of UNE leasing issues for the Fairbanks and Juneau markets.

Galaxy XR

On August 3, 2004 Galaxy XR, our primary satellite used to provide voice, data and Internet services to our rural Alaska customers, experienced a failure of its secondary xenon ion propulsion system ("XIPS") that maintains the satellite's proper orbital position. The primary XIPS had previously failed in February 2004. The satellite is now using its backup bi-propellant thrusters, which are a space flight proven technology, to maintain its orbital position. The failure of the primary and secondary XIPS had no impact on service to our customers. PanAmSat Corporation ("PanAmSat"), the owner and operator of Galaxy XR, believes there is sufficient bi-propellant fuel on board the spacecraft to continue normal operations until the first or second quarter of 2008. The term of our Galaxy XR transponder purchase agreement extends through March 2012. PanAmSat intends to replace the satellite prior to its estimated end-of-life. We purchased a warranty as part of the original agreement to cover a potential loss of this nature. We have an agreement in place that provides backup transponder capacity on Galaxy XIII in the event of a catastrophic failure of Galaxy XR. We do not believe failure of the primary and secondary XIPS systems will have a material adverse effect on our financial position, results of operations, or our liquidity.

Universal Service Administrative Company Account Receivable

The FCC directed the Universal Service Administrative Company ("USAC"), the administrator of the Schools and Libraries and Rural Health Care Universal Service Support Mechanisms, to change their accounting methodology by October 1, 2004 to the same methodology that the Federal

GENERAL COMMUNICATION, INC. AND SUBSIDIARIES
Notes to Interim Condensed Consolidated Financial Statements
(Unaudited)

Government uses. Among other things, USAC was informed that this required them to change the rules that they use to account for various financial transactions, including Funding Commitment Decision Letters ("FCDLs") in those programs.

In the past, USAC allocated funds for accounting purposes to pay for services in those programs at the time an invoice submitted by a service provider was approved for payment. Under the new accounting rules, however, it has been determined that issuance of the FCDL is the point at which an "obligation" occurs for Federal Government accounting purposes. Another significant change requires USAC to have cash or federal securities on hand at least equal to the value of all its outstanding FCDLs. Until this decision, USAC was only required to have money on hand when the vendor sent an invoice to USAC for payment.

USAC suspended issuance of FCDLs in early August, 2004, but indicated that it has sufficient funds on hand to cover all FCDLs it had previously issued. USAC also indicated that new funding commitments could not be issued until additional unobligated funds are made available. On November 3, 2004, USAC announced that it had determined the amount of unobligated cash available and issuance of FCDLs had resumed up to that amount. In the future FCDLs will be issued as further cash is available through Universal Service Fund receipts.

At September 30, 2004 we had approximately \$5.4 million in outstanding funding requests for which FCDLs had been suspended by USAC. We believe that Universal Service funds will become available to USAC to cover these FCDLs. If we conclude that we will not be able to collect part or all of the outstanding balance from USAC, the provision of an allowance for doubtful accounts could have a material adverse effect on our financial position, results of operations and liquidity.

Cable Services Property Acquisition

On August 24, 2004 we signed an Asset Purchase and Sale Agreement to acquire the assets of Barrow Cable TV, Inc. We are awaiting the RCA's approval of the acquisition. We expect to finalize the acquisition with a cash payment of approximately \$1.6 million during the first quarter of 2005.

PART I.
ITEM 2.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS
(Unaudited)**

In the following discussion, General Communication, Inc. and its direct and indirect subsidiaries are referred to as "we," "us" and "our."

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to unbilled revenues, Cost of Goods Sold (exclusive of depreciation, amortization and accretion shown separately) ("Cost of Goods Sold") accruals, allowance for doubtful accounts, depreciation, amortization and accretion periods, intangible assets, income taxes, and contingencies and litigation. We base our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. See also our "Cautionary Statement Regarding Forward-Looking Statements."

General Overview

Through our focus on long-term results, acquisitions, and strategic capital investments, we strive to consistently grow our revenues and expand our margins. We have historically met our cash needs for operations, regular capital expenditures and maintenance capital expenditures through our cash flows from operating activities. Historically, cash requirements for significant acquisitions and major capital expenditures have been provided largely through our financing activities. We funded the construction of a new fiber optic cable system through our operating cash flows and, to the extent necessary, with draws on our new Senior Credit Facility, as further discussed in Liquidity and Capital Resources in this report.

Results of Operations

The following table sets forth selected Statement of Income data as a percentage of total revenues for the periods indicated (underlying data rounded to the nearest thousands):

(Unaudited)	Three Months Ended		Percentage	Nine Months Ended		Percentage
	September 30, <u>2004</u>	September 30, <u>2003</u>	Change ¹ 2004 vs. <u>2003</u>	September 30, <u>2004</u>	September 30, <u>2003</u>	Change ¹ 2004 vs. <u>2003</u>
Statement of Income Data:						
Revenues:						
Long-distance services segment	51.2%	54.1%	2.6%	49.8%	53.4%	3.8%
Cable services segment	23.6%	24.1%	6.4%	23.6%	24.7%	6.0%
Local access services segment	10.8%	9.7%	21.0%	10.8%	9.5%	27.0%
Internet services segment	6.3%	5.0%	35.5%	6.1%	5.0%	37.0%
All other	8.1%	7.1%	23.9%	9.7%	7.4%	44.9%
Total revenues	100.0%	100.0%	8.4%	100.0%	100.0%	11.2%
Selling, general and administrative expenses	35.0%	35.9%	5.8%	34.1%	35.7%	6.1%
Bad debt expense (recovery)	(0.3%)	0.5%	(152.7%)	(0.4%)	0.7%	160.3%
Depreciation, amortization and accretion expense	14.3%	13.3%	17.1%	14.6%	13.7%	18.8%
Operating income	20.1%	17.9%	21.7%	18.8%	17.8%	17.7%
Net income before income taxes and cumulative effect of a change in accounting principle in 2003	13.5%	8.4%	73.5%	9.5%	7.7%	38.3%
Net income before cumulative effect of a change in accounting principle in 2003	8.7%	4.6%	105.2%	5.9%	4.3%	52.4%
Net income	8.7%	4.6%	105.2%	5.9%	4.1%	59.3%

(Unaudited)	Three Months Ended		Percentage	Nine Months Ended		Percentage
	September 30, 2004	September 30, 2003	Change ¹ 2004 vs. 2003	September 30, 2004	September 30, 2003	Change ¹ 2004 vs. 2003
Other Operating Data:						
Long-distance services segment operating income ²	50.1%	45.7%	12.4%	44.9%	46.1%	1.0%
Cable services segment operating income ³	23.6%	22.5%	11.5%	25.4%	25.1%	7.3%
Local access services segment operating loss ⁴	(15.9%)	(17.9%)	(7.6%)	(9.1%)	(21.3%)	45.5%
Internet services segment operating income ⁵	22.1%	9.4%	219.3%	18.7%	8.0%	222.4%

¹ Percentage change in underlying data.

² Computed by dividing total external long-distance services segment operating income by total external long-distance services segment revenues.

³ Computed by dividing total external cable services segment operating income by total external cable services segment revenues.

⁴ Computed by dividing total external local access services segment operating loss by total external local access services segment revenues.

⁵ Computed by dividing total external Internet services segment operating income by total external Internet services segment revenues.

Three Months Ended September 30, 2004 ("2004") Compared To Three Months Ended September 30, 2003 ("2003")

Overview of Revenues and Cost of Goods Sold

Total revenues increased 8.4% from \$98.3 million in 2003 to \$106.6 million in 2004. All of our segments and All Other Services contributed to the increase in total revenues. See the discussion below for more information by segment.

Total Cost of Goods Sold increased 3.2% from \$31.9 million in 2003 to \$32.9 million in 2004. Our cable services, local access services and Internet services segments and All Other Services contributed to the increase in total Cost of Goods Sold, partially off-set by a decrease in long-distance services Cost of Goods Sold. See the discussion below for more information by segment.

Long-Distance Services Segment Overview

Long-distance services segment revenue in 2004 represented 51.2% of consolidated revenues. Our provision of interstate and intrastate long-distance services, private line and leased dedicated capacity services, and broadband services accounted for 91.1% of our total long-distance services segment revenues during 2004.

Factors that have the greatest impact on year-to-year changes in long-distance services revenues include the rate per minute charged to customers, usage volumes expressed as minutes of use, and the number of private line, leased dedicated service and broadband products in use.

Due in large part to the favorable synergistic effects of our bundling strategy, the long-distance services segment continues to be a significant contributor to our overall performance, although the migration of traffic from voice to data and from fixed to mobile wireless continues.

Our long-distance services segment faces significant competition from AT&T Alascom, long-distance resellers, and local telephone companies that have entered the long-distance market. We believe our approach to developing, pricing, and providing long-distance services and bundling different business segment services will continue to allow us to be competitive in providing those services.

The initial term of our contract to provide interstate and intrastate long-distance services to Sprint ends in March 2007 with two one-year automatic extensions to March 2009. In June 2004 we amended the original agreement resulting in new annual rate reductions beginning July 2004. Contractual rate reductions will continue to occur annually through the end of the initial term of the contract.

On July 21, 2002 MCI and substantially all of its active United States subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court. On July 22, 2003, the United States Bankruptcy Court approved a settlement agreement for pre-petition amounts owed to us by MCI and affirmed all of our existing contracts with MCI. MCI emerged from bankruptcy protection on April 20, 2004. The remaining pre-petition accounts receivable balance owed by MCI to us after this settlement was \$11.1 million ("MCI credit") which we have used and will continue to use as a credit against amounts payable for services purchased from MCI.

After settlement, we began reducing the MCI credit as we utilized it for services otherwise payable to MCI. We have accounted for our use of the MCI credit as a gain contingency, and, accordingly, are recognizing a reduction of bad debt expense as services are provided by MCI and the credit is realized. During 2004 and 2003 we realized approximately \$1.1 million and \$647,000, respectively, of the MCI credit against amounts payable for services received from MCI.

The remaining unused MCI credit totaled \$4.5 million and \$7.9 million at September 30, 2004 and December 31, 2003, respectively. The credit balance is not recorded on the Consolidated Balance Sheet as we are recognizing recovery of bad debt expense as the credit is realized.

Other common carrier traffic routed to us for termination in Alaska is largely dependent on traffic routed to MCI and Sprint by their customers. Pricing pressures, new program offerings, business failures, and market and business consolidations continue to evolve in the markets served by MCI and Sprint. If, as a result, their traffic is reduced, or if their competitors' costs to terminate or originate traffic in Alaska are reduced, our traffic will also likely be reduced, and our pricing may be reduced to respond to competitive pressures. Additionally, a protracted economic malaise in the 48 contiguous states south of or below Alaska ("Lower 48 States") or a disruption in the economy resulting from terrorist attacks and other attacks or acts of war could affect our carrier customers. We are unable to predict the effect on us of such changes, however given the materiality of other common carrier revenues to us, a significant reduction in traffic or pricing could have a material adverse effect on our financial position, results of operations and liquidity.

Long-distance Services Segment Revenues

Total long-distance services segment revenues increased 2.6% to \$54.6 million in 2004. The components of long-distance services segment revenues are as follows (amounts in thousands):

	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Common carrier message telephone services	\$ 21,046	24,643	(14.6%)
Residential, commercial and governmental message telephone services	10,149	10,133	0.2%
Private line and private network services	10,973	9,167	19.7%
Broadband services	7,542	6,364	18.5%
Lease of fiber optic cable system capacity	4,840	2,884	67.8%
Total long-distance services segment revenue	<u>\$ 54,550</u>	<u>53,191</u>	<u>2.6%</u>

Common Carrier Message Telephone Services Revenue

The 2004 decrease in message telephone service revenues from other common carriers (principally MCI and Sprint) resulted from the following:

- A 8.7% decrease in the average rate per minute on minutes carried for other common carriers primarily due to the decreased average rate per minute as agreed to in the June 2004 amendment of our contract to provide interstate and intrastate long-distance services to Sprint, and
- A 4.2% decrease in wholesale minutes carried to 233.5 million minutes.

Residential, Commercial, and Governmental Message Telephone Services Revenue

Selected key performance indicators for our offering of message telephone service to residential, commercial, and governmental customers follow:

	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Retail minutes carried	77.3 million	70.8 million	9.2%
Average rate per minute ¹	\$0.133	\$0.140	(5.0%)
Number of active residential, commercial and governmental customers ²	90,300	86,200	4.8%

¹ Residential, commercial, and governmental message telephone services revenues excluding plan fees associated with the carriage of data services divided by the retail minutes carried.

² All current subscribers who have had calling activity during September 2004 and 2003, respectively.

The decrease in message telephone service revenues from residential, commercial, and governmental customers in 2004 is primarily due to a decrease in the average rate per minute. Our average rate per minute decrease is primarily due to our promotion of and customers' enrollment in calling plans offering a certain number of minutes for a flat monthly fee.

The decrease in message telephone service revenues from residential, commercial, and governmental customers in 2004 is partially off-set by the following:

- Increased minutes carried for these customers primarily due to our contract to provide services to the State of Alaska starting in the first quarter of 2004, and
- An increase in the number of active residential, commercial, and governmental customers billed primarily due to our promotion of and our customers' enrollment in a new bundled offering to our residential customers starting in the first quarter of 2004, partially off-set by the effect of customers substituting cellular phone, prepaid calling card, and email usage for direct dial minutes.

Broadband Services Revenue

The increase in revenues from our packaged telecommunications offerings to rural hospitals and health clinics and our SchoolAccess™ offering to rural school districts in 2004 is primarily due to the following:

- An increased number of circuits leased to rural hospitals, health clinics, and rural school districts to both existing and a new customer resulting in increased revenue of \$334,000, and
- An \$886,000 increase in special project revenue for services sold to the federal government.

Fiber Optic Cable System Capacity Lease Revenue

The increase in revenues from the lease of fiber optic cable system capacity is primarily due to a contract to lease capacity on the AULP East fiber optic cable system resulting in increased monthly revenue of approximately \$430,000 starting in July 2004.

Long-distance Services Segment Cost of Goods Sold

Long-distance services segment Cost of Goods Sold decreased 16.9% to \$12.0 million in 2004 primarily due to the following:

- A \$472,000 credit received in 2004 from a vendor due to a rate overcharge,
- A 4.2% decrease in wholesale minutes carried,
- Reductions in access costs due to distribution and termination of our traffic on our own local access services network instead of paying other carriers to distribute and terminate our traffic. The statewide average cost savings is approximately \$.010 and \$.062 per minute for interstate and intrastate traffic, respectively. We expect cost savings to continue to occur as long-distance traffic originated, carried, and terminated on our own facilities grows, and
- In the course of business we estimate unbilled long-distance services Cost of Goods Sold based upon minutes of use processed through our network and established rates. Such estimates are revised when subsequent billings are received, payments are made, billing matters are researched and resolved, tariffed billing periods lapse, or when disputed charges are resolved. In 2004 and 2003, we had favorable adjustments of \$450,000 and \$624,000, respectively.

The decrease in the long-distance services segment Cost of Goods Sold is partially off-set by a 9.2% increase in retail minutes carried.

Long-distance Services Segment Operating Income

Long-distance services segment operating income increased 12.4% to \$27.3 million from 2003 to 2004 primarily due to the following:

- The 2.6% increase in long-distance services segment revenues to \$54.6 million in 2004,
- The 16.9% decrease in long-distance services segment Cost of Goods Sold to \$12.0 million in 2004, and
- A \$443,000 increase in bad debt recovery due to an increase in the realization of the MCI credit in 2004 as compared to 2003, as further discussed in the “Long Distance Service Segment Overview” above.

The increase in the long-distance services segment operating income was partially off-set by a 3.7% increase in long-distance services segment selling, general and administrative expenses to \$9.8 million in 2004 as compared to 2003.

Cable Services Segment Overview

Cable services segment revenues in 2004 represented 23.6% of consolidated revenues. Our cable systems serve 35 communities and areas in Alaska, including the state's four largest population centers, Anchorage, Fairbanks, the Matanuska-Susitna Valley and Juneau.

We generate cable services segment revenues from four primary sources: (1) digital and analog programming services, including monthly basic and premium subscriptions, pay-per-view movies and other one-time events, such as sporting events; (2) equipment rentals and installation; (3) cable modem services (shared with our Internet services segment); and (4) advertising sales. During 2004 programming services generated 71.9% of total cable services segment revenues, cable services' allocable share of cable modem services accounted for 12.3% of such revenues, equipment rental and installation fees accounted for 9.7% of such revenues, advertising sales accounted for 5.2% of such revenues, and other services accounted for the remaining 0.9% of total cable services segment revenues.

The primary factors that contribute to year-to-year changes in cable services segment revenues include average monthly subscription and pay-per-view rates, the mix among basic, premium and pay-per-view services and digital and analog services, the average number of cable television and cable modem subscribers during a given reporting period, revenues generated from new product offerings, and sales of cable advertising services.

We distribute local Anchorage programming to all of our cable systems. This local programming provides additional value to our cable subscribers that not all our Direct Broadcast Satellite (“DBS”) competitors can provide. In the third quarter of 2003 DBS service provider Dish Network (EchoStar Communications Corporation) began providing, for an additional fee, Anchorage based broadcaster programming in Anchorage and in other Alaska communities where there is not a similar local broadcast affiliate.

Cable Services Segment Revenues and Cost of Goods Sold

Selected key performance indicators for our cable services segment follow:

	September 30,		Percentage
	2004	2003	Change
Basic subscribers	134,300	135,300	(0.7%)
Digital special interest subscribers	42,600	34,800	22.4%
Cable modem subscribers	61,200	42,800	43.0%
Homes passed	206,000	201,100	2.4%

A basic cable subscriber is defined as one basic tier of service delivered to an address or separate subunits thereof regardless of the number of outlets purchased. A digital special interest subscriber is defined as one digital special interest tier of service delivered to an address or separate subunits thereof regardless of the number of outlets purchased.

A cable modem subscriber is defined by the purchase of cable modem service regardless of the level of service purchased. If one entity purchases multiple cable modem service access points, that entity is included in our cable modem subscriber count at a rate equal to the number of access points purchased.

Total cable services segment revenues increased 6.4% to \$25.2 million and average gross revenue per average basic subscriber per month increased \$4.78 or 8.0% in 2004.

The increase in cable services segment revenues is primarily due to the following:

- A 14.3% increase to \$3.1 million in 2004 in its share of cable modem revenue (offered through our Internet services segment) due to an increased number of cable modems deployed. Approximately 99% of our cable homes passed are able to subscribe to our cable modem service, and
- A 67.3% increase in advertising sales revenue to \$1.3 million in 2004 primarily caused by an increase in Olympic and national and local political advertising.

We now offer digital cable television service in Anchorage, the Matanuska-Susitna Valley, Fairbanks, Juneau, Ketchikan, Kenai, Soldotna, Kodiak, Seward, Cordova, Valdez, and Nome, representing approximately 94% of our total homes passed at September 30, 2004. We launched digital cable television services in the Ketchikan cable system in the third quarter of 2003, in the Kodiak cable system in the first quarter of 2004, in the Cordova and Seward cable systems in the second quarter of 2004, and in the Valdez and Nome cable systems in the third quarter of 2004. Our digital service offering varies among cable systems with the digital special interest programming tier only available in Anchorage, the Matanuska-Susitna Valley, Fairbanks, Juneau, Ketchikan, Kenai and Soldotna.

Cable services Cost of Goods Sold increased 4.4% to \$6.9 million in 2004 due to programming cost increases for most of our cable programming services offerings.

Cable Services Segment Operating Income

Cable services segment operating income increased 11.5% to \$5.9 million from 2003 to 2004. Increased revenues of approximately \$1.5 million were partially off-set by increases in cable services segment Cost of Goods Sold of approximately \$293,000, selling, general, and administrative expenses

of approximately \$211,000 to \$7.4 million and depreciation, amortization and accretion expense of approximately \$323,000 to \$4.7 million.

Local Access Services Segment Overview

We generate local access services revenues from three primary sources: (1) business and residential basic dial tone services; (2) business private line and special access services; and (3) business and residential features and other charges, including voice mail, caller ID, distinctive ring, inside wiring and subscriber line charges. During 2004 local access services revenues represented 10.8% of consolidated revenues.

The primary factors that contribute to year-to-year changes in local access services revenues include the average number of business and residential subscribers to our services during a given reporting period, the average monthly rates charged for non-traffic sensitive services, the number and type of additional premium features selected, the traffic sensitive access rates charged to carriers and the Universal Service Program.

Our local access services segment faces significant competition in Anchorage, Fairbanks, and Juneau from ACS, which is the largest ILEC in Alaska, and from AT&T Alascom, Inc. in Anchorage for residential services. We believe our approach to developing, pricing, and providing local access services and bundling different business segment services will allow us to be competitive in providing those services.

At September 30, 2004, 110,400 lines were in service as compared to approximately 103,400 lines in service at September 30, 2003. We estimate that our 2004 lines in service represents a statewide market share of approximately 24%. A line in service is defined as a revenue generating circuit or channel connecting a customer to the public switched telephone network.

Our access line mix at September 30, 2004 follows:

- Residential lines represent approximately 61% of our lines,
- Business customers represent approximately 35% of our lines, and
- Internet access customers represent approximately 4% of our lines.

In April 2004 we successfully launched our Digital Local Phone Service (“DLPS”) deployment utilizing our Anchorage coaxial cable facilities. This service delivery method allows us to utilize our own cable facilities to provide local access service to our customers and avoid paying local loop charges to the ILEC. To ensure the necessary equipment is available to us, we have committed to purchase a certain number of outdoor, network powered multi-media adapters. At September 30, 2004 we had approximately 4,000 DLPS lines in service.

Approximately 85% of our lines are provided on our own facilities and leased local loops. Approximately 6% of our lines are provided using the UNE platform delivery method.

In December 2003 we distributed our new phone directory and began recognizing revenue and Cost of Goods Sold in the local access services segment. We recognized one month of revenue and Cost of Goods Sold in the fourth quarter of 2003 and are recognizing the remaining eleven months of revenue and Cost of Goods Sold in 2004.

In October 2004 we completed distribution our new Fairbanks and Juneau area directories. We will recognize three months of revenue and Cost of Goods Sold in 2004 and will recognize the remaining nine months of revenue and Cost of Goods Sold in 2005.

Local Access Services Segment Revenues and Cost of Goods Sold

Local access services segment revenues increased 21.0% in 2004 to \$11.5 million primarily due to the following:

- Growth in the average number of lines in service,
- \$485,000 increase in support from the Universal Service Program, and
- Revenues of \$468,000 from our new phone directory distributed in December 2003.

The increase in local access services segment revenue is partially off-set by access rate decreases.

Local access services segment Cost of Goods Sold increased 31.7% to \$7.8 million in 2004 primarily due to the growth in the average number of lines in service and the increased costs resulting from the RCA's Anchorage UNE arbitration settlement order in June 2004 which increased the UNE lease rate from \$14.92 to \$18.64 per line per month beginning on June 25, 2004.

Local Access Services Segment Operating Loss

Local access services segment operating loss increased approximately \$129,000 to (\$1.8) million from 2003 to 2004. The increased operating loss is primarily due to increased Cost of Goods Sold of approximately \$1.9 million as previously described and increased depreciation, amortization and accretion expense of approximately \$88,000 to \$964,000. Partially off-setting the increased local access services segment operating loss are increased revenues of approximately \$2.0 million as previously described.

The local access services segment operating results are negatively affected by the allocation of the benefit of access cost savings to the long-distance services segment. If the local access services segment received credit for the access charge reductions recorded by the long distance services segment, the local access services segment operating loss would have improved by approximately \$1.9 million and the long distance services segment operating income would have been reduced by an equal amount in 2004. Avoided access charges totaled approximately \$1.6 million in 2003. The amount of allocated access cost savings is affected by access rate decreases from 2003 to 2004.

Internet Services Segment Overview

We generate Internet services revenues from three primary sources: (1) access product services, including commercial, Internet service provider, and retail dial-up access; (2) network management services; and (3) Internet services' allocable share of cable modem revenue (a portion of cable modem revenue is also recognized by our cable services segment). During 2004 Internet services segment revenues represented 6.3% of consolidated revenues.

The primary factors that contribute to year-to-year changes in Internet services revenues include the average number of subscribers to our services during a given reporting period, the average monthly subscription rates, the amount of bandwidth purchased by large commercial customers, and the number and type of additional premium features selected.

Marketing campaigns continue to be deployed targeting residential and commercial customers featuring bundled products. Our Internet offerings are bundled with various combinations of our long-distance, cable, and local access services offerings and provide free or discounted basic or premium Internet services. Value-added premium Internet features are available for additional charges.

We compete with a number of Internet service providers in our markets. We believe our approach to developing, pricing, and providing Internet services allows us to be competitive in providing those services.

Internet Services Segment Revenues and Cost of Goods Sold

Selected key performance indicators for our Internet services segment follow:

	September 30,		Percentage
	2004	2003	Change
Total Internet subscribers	101,100	93,900	7.7%
Cable modem subscribers	61,200	42,800	43.0%
Dial-up subscribers	39,900	51,100	(21.9%)

Total Internet subscribers are defined by the purchase of Internet access service regardless of the level of service purchased. If one entity purchases multiple Internet access service points, that entity is included in our total Internet subscriber count at a rate equal to the number of access points purchased. A subscriber with both cable modem and dial-up service is included once as a cable modem subscriber.

A dial-up subscriber is defined by the purchase of dial-up Internet service regardless of the level of service purchased. If one entity purchases multiple dial-up service access points, that entity is included in our dial-up subscriber count at a rate equal to the number of access points purchased.

Total Internet services segment revenues increased 35.5% to \$6.7 million in 2004 primarily due to the 30.1% increase in its allocable share of cable modem revenues to \$2.9 million in 2004 as compared to 2003. The increase in cable modem revenues is primarily due to growth in cable modem subscribers.

The decrease in dial-up subscribers from 2003 to 2004 is primarily due to the migration of existing dial-up subscribers to our cable modem access service.

Internet services segment Cost of Goods Sold increased 12.5% to \$1.7 million in 2004 associated with increased Internet services segment revenues.

Internet Services Segment Operating Income

Internet services segment operating income increased \$1.0 million to \$1.5 million from 2003 to 2004. Increased revenues of approximately \$1.7 million were partially off-set by increased Cost of Goods Sold of approximately \$189,000, increased selling, general and administrative expenses of approximately \$457,000 to \$2.5 million and increased depreciation, amortization and accretion expense of approximately \$50,000 to \$879,000.

All Other Overview

Revenues reported in the All Other category as described in note 6 in the accompanying “Notes to Interim Condensed Consolidated Financial Statements” include our managed services, product sales, and cellular telephone services.

Revenues included in the All Other category represented 8.1% of consolidated revenues in 2004.

All Other Revenues and Cost of Goods Sold

All Other revenues increased 23.9% to \$8.6 million in 2004. The increase is primarily due to the following:

- Special project revenue for services sold to a certain customer,
- Revenue generated from our contract to provide services to the State of Alaska starting in the first quarter of 2004.

All Other Cost of Goods Sold increased 30.9% to \$4.5 million in 2004. The increase is primarily due to costs associated with the special project revenue described above.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 5.8% to \$37.3 million in 2004 primarily due to a \$1.2 million increase in contract labor and contract services expenses associated with our Sarbanes-Oxley Act of 2002 ("SOX") Section 404 compliance efforts and other special projects, a \$1.1 million write-off of previously capitalized mobile wireless network costs upon finalization of a long-term distribution agreement, and a \$1.0 million increase in labor and health insurance costs. The increases previously described are partially off-set by a \$1.3 million decrease in our company-wide success sharing bonus accrual. As a percentage of total revenues, selling, general and administrative expenses decreased to 35.0% in 2004 from 35.9% in 2003, primarily due to an increase in revenues without a corresponding proportional increase in selling, general and administrative expenses.

Bad Debt Expense (Recovery)

Bad debt expense decreased 152.7% to a net recovery of (\$281,000) in 2004. The 2004 decrease is primarily due to realization of approximately \$1.1 million of the MCI credit through a reduction to bad debt expense in 2004, as further discussed in the "Long Distance Service Segment Overview" above.

Depreciation, Amortization and Accretion Expense

Depreciation, amortization and accretion expense increased 17.1% to \$15.3 million in 2004. The increase is primarily attributed to our \$45.8 million investment in equipment and facilities placed into service during the twelve-month period ended December 31, 2003 for which a full year of depreciation will be recorded in the twelve-month period ended December 31, 2004, and the \$96.5 million investment in equipment and facilities placed into service during nine-month period ended September 30, 2004 for which a partial year of depreciation will be recorded in the twelve-month period ended December 31, 2004.

Other Expense, Net

Other expense, net of other income, decreased 24.5% to \$7.0 million in 2004. The decrease is primarily due to a \$1.9 million decrease in interest expense in 2004 on our new Senior Credit Facility due to a decrease in the average outstanding balance owed on our new Senior Credit Facility and a decreased new Senior Credit Facility interest rate as compared to 2003.

Income Tax Expense

Income tax expense was \$5.1 million in 2004 and \$3.8 million in 2003. The change was due to increased net income before income taxes in 2004 as compared to 2003. Our effective income tax rate

decreased from 45.3% in 2003 to 35.3% in 2004 due to the decreasing proportion of items that are nondeductible for income tax purposes and adjustment of deferred tax assets and liabilities in 2004.

At September 30, 2004, we have (1) tax net operating loss carryforwards of approximately \$173.9 million that will begin expiring in 2005 if not utilized, and (2) alternative minimum tax credit carryforwards of approximately \$2.0 million available to offset regular income taxes payable in future years. We utilized net operating loss carryforwards of approximately \$8.8 million during the nine months ended September 30, 2004. Our utilization of certain net operating loss carryforwards is subject to limitations pursuant to Internal Revenue Code section 382.

Tax benefits associated with recorded deferred tax assets are considered to be more likely than not realizable through future reversals of existing taxable temporary differences and future taxable income exclusive of reversing temporary differences and carryforwards. The amount of deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced which would result in additional income tax expense. We estimate that our effective annual income tax rate for financial statement purposes will be 38% to 40% in 2004.

On October 22, 2004 the American Jobs Creation Act of 2004 was signed into law. We believe this new law will not have a material effect on our results of operations, financial position and cash flows.

Nine Months Ended September 30, 2004 (“2004”) Compared To Nine Months Ended September 30, 2003 (“2003”)

Overview of Revenues and Cost of Goods Sold

Total revenues increased 11.2% from \$287.0 million in 2003 to \$319.3 million in 2004. All of our segments and All Other Services contributed to the increase in total revenues. See the discussion below for more information by segment.

Total Cost of Goods Sold increased 13.8% from \$92.2 million in 2003 to \$104.9 million in 2004. All of our segments and All Other Services contributed to the increase in total Cost of Goods Sold. See the discussion below for more information by segment.

Long-Distance Services Segment Overview

Long-distance services revenue in 2004 represented 49.8% of consolidated revenues. Our provision of interstate and intrastate long-distance services, private line and leased dedicated capacity services, and broadband services accounted for 92.8% of our total long-distance services segment revenues during 2004.

Long-distance Services Segment Revenues

Total long-distance services segment revenues increased 3.8% to \$159.1 million in 2004. The components of long-distance services segment revenues are as follows (amounts in thousands):

	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Common carrier message telephone services	\$ 62,885	68,680	(8.4%)
Residential, commercial and governmental message telephone services	30,406	30,526	(0.4%)
Private line and private network services	32,008	27,384	16.9%
Broadband services	22,382	18,380	21.8%
Lease of fiber optic cable system capacity	11,430	8,277	38.1%
Total long-distance services segment revenue	<u>\$ 159,111</u>	<u>153,247</u>	<u>3.8%</u>

Common Carrier Message Telephone Services Revenue

The 2004 decrease in message telephone service revenues from other common carriers (principally MCI and Sprint) resulted from the following:

- An 11.0% decrease in the average rate per minute on minutes carried for other common carriers primarily due to the decreased average rate per minute as agreed to in the June 2004 amendment of our contract to provide interstate and intrastate long-distance services to Sprint and in the July 2003 extension of our contract to provide interstate and intrastate long-distance services to MCI, and
- A discount given to a certain other common carrier customer starting in the third quarter of 2003.

The decrease in message telephone service revenues from other common carriers in 2004 was partially off-set by a 5.7% increase in wholesale minutes carried to 675.7 million minutes.

Residential, Commercial and Governmental Message Telephone Services Revenue

Selected key performance indicators for our offering of message telephone service to residential, commercial and governmental customers follow:

	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Retail minutes carried	230.3 million	215.3 million	7.0%
Average rate per minute ¹	\$0.132	\$0.139	(5.0%)
Number of active residential, commercial and governmental customers ²	90,300	86,200	4.8%

¹ Residential, commercial and governmental message telephone services excluding plan fees associated with the carriage of data services divided by the retail minutes carried.

² All current subscribers who have had calling activity during September 2004 and 2003, respectively.

The decrease in message telephone service revenues from residential, commercial, and governmental customers in 2004 is primarily due to a decrease in the average rate per minute. Our average rate per minute decrease is primarily due to our promotion of and customers' enrollment in calling plans offering a certain number of minutes for a flat monthly fee.

The decrease in message telephone service to residential, commercial and governmental customers in 2004 is partially off-set by the following:

- Increased minutes carried for these customers primarily due to our contract to provide services to the State of Alaska starting in the first quarter of 2004, and
- An increase in the number of active residential, commercial, and governmental customers billed primarily due to our promotion of and our customers' enrollment in a new bundled offering to our residential customers, partially off-set by the effect of customers substituting cellular phone, prepaid calling card, and email usage for direct dial minutes.

Broadband Services Revenue

The increase in revenues from our packaged telecommunications offering to rural hospitals and health clinics and our SchoolAccess™ offering to rural school districts in 2004 is primarily due to the following:

- An increased number of circuits leased to rural hospitals, health clinics, and rural school districts to both existing and a new customer resulting in increased revenue of \$1.8 million, and
- A \$2.2 million increase in special project revenue for services sold to the federal government.

Long-distance Services Segment Cost of Goods Sold

Long-distance services segment Cost of Goods Sold increased 2.8% to \$40.6 million in 2004 primarily due to the following:

- A 7.0% increase in retail minutes carried,
- A 5.7% increase in wholesale minutes carried, and
- A \$2.3 million refund (\$1.9 million after deducting certain direct costs) in 2003 from a local exchange carrier in respect of its earnings that exceeded regulatory requirements that did not recur in 2004.

The increase in the long-distance services segment Cost of Goods Sold is partially off-set by the following:

- A \$472,000 credit received in 2004 from a vendor due to a rate overcharge,
- In the course of business we estimate unbilled long-distance services Cost of Goods Sold based upon minutes of use processed through our network and established rates. Such estimates are revised when subsequent billings are received, payments are made, billing matters are researched and resolved, tariffed billing periods lapse, or when disputed charges are resolved. In 2004 and 2003, we had favorable adjustments of \$450,000 and \$1.4 million, respectively.
- Reductions in access costs due to distribution and termination of our traffic on our own local access services network instead of paying other carriers to distribute and terminate our traffic. The statewide average cost savings is approximately \$.010 and \$.062 per minute for interstate and intrastate traffic, respectively. We expect cost savings to continue to occur as long-distance traffic originated, carried, and terminated on our own facilities grows.

Long-distance Services Segment Operating Income

Long-distance services segment operating income increased 1.0% to \$71.4 million from 2003 to 2004 primarily due to the following:

- The 3.8% increase in long-distance services segment revenues to \$159.1 million in 2004, and
- Realization of approximately \$3.4 million of the MCI credit through a reduction to bad debt expense in 2004, as further discussed in the “Long Distance Service Overview” above. We realized approximately \$647,000 of the MCI credit through a reduction to bad debt expense in 2003.

The long-distance services segment operating income increase was partially off-set by the following:

- The 2.8% increase in long-distance services segment costs of goods sold to \$40.6 million in 2004, as discussed above,
- An 8.7% increase in long-distance services segment selling, general and administrative expenses to \$29.9 million primarily due to an increase of approximately \$820,000 in promotion expenses and an increase of approximately \$925,000 in fiber repair expenses in 2004 and compared to 2003. The increase in fiber repair expenses is the result of the repair of AULP East in July 2004 with an estimated total repair cost of approximately \$400,000 and an accrual reversal of \$525,000 in 2003, and
- A 34.7% increase in long-distance services segment depreciation, amortization and accretion expense to \$19.6 million in 2004 as compared to 2003 primarily due to our investment in long-distance services segment equipment and facilities placed into service during the twelve-month period ended December 31, 2003 for which a full year of depreciation will be recorded in the twelve-month period ended December 31, 2004, and our investment in long-distance services segment equipment and facilities placed into service during the nine-month period ended September 30, 2004 for which a partial year of depreciation will be recorded in the twelve-month period ended December 31, 2004.

Cable Services Segment Overview

Cable services segment revenues in 2004 represented 23.6% of consolidated revenues. During 2004 programming services generated 72.9% of total cable services segment revenues, cable services' allocable share of cable modem services accounted for 12.8% of such revenues, equipment rental and installation fees accounted for 9.5% of such revenues, advertising sales accounted for 3.9% of such revenues, and other services accounted for the remaining 0.9% of total cable services revenues.

Cable Services Segment Revenues and Cost of Goods Sold

Total cable services segment revenues increased 6.0% to \$75.2 million and average gross revenue per average basic subscriber per month increased \$7.11 or 11.9% in 2004.

The increase in cable services segment revenues is primarily due to the following:

- A 86.9% increase in digital set-top box rental revenue to \$5.8 million in 2004 primarily caused by the increased use of digital distribution technology, and
- A 21.6% increase in its share of cable modem revenue (offered through our Internet services segment) to \$9.6 million in 2004 due to an increased number of cable modems deployed. Approximately 99% of our cable homes passed are able to subscribe to our cable modem service.

Cable services segment Cost of Goods Sold increased 4.5% to \$20.3 million in 2004 due to programming cost increases for most of our cable programming service offerings. The increase in Cable services segment Cost of Goods Sold is partially off-set by a refund received in 2004 from a supplier retroactive to August 2003 and an arrangement with a supplier in which we received a rebate in 2004 upon us meeting a specified goal.

Cable Services Segment Operating Income

Cable services segment operating income increased \$1.3 million to \$19.1 million from 2003 to 2004 primarily due to the 6.0% increase in cable services segment revenues to \$75.2 million in 2004, partially off-set by the following:

- The 4.5% increase in cable services segment Costs of Goods Sold to \$20.3 million in 2004, as described above,
- A \$1.3 million increase in cable services segment selling, general and administrative expenses to \$21.1 million primarily due to a \$1.9 million increase in labor and employee benefits costs, and
- A 4.7% increase in cable services segment depreciation, amortization and accretion expense to \$14.1 million in 2004 as compared to 2003 primarily due to our investment in cable services segment equipment and facilities placed into service during the twelve-month period ended December 31, 2003 for which a full year of depreciation will be recorded in the twelve-month period ended December 31, 2004, and our investment in cable services segment equipment and facilities placed into service during the nine-month period ended September 30, 2004 for which a partial year of depreciation will be recorded in the twelve-month period ended December 31, 2004.

Multiple System Operator (“MSO”) Operating Statistics

Our operating statistics include capital expenditures and customer information from our cable services segment and the components of our local access services and Internet services segments which offer services utilizing our cable services’ facilities.

Our capital expenditures by standard reporting category for the nine month periods ending September 30, 2004 and 2003 follows (amounts in thousands):

	2004	2003
Customer premise equipment	\$ 12,136	6,880
Commercial	348	395
Scalable infrastructure	3,782	1,000
Line extensions	517	645
Upgrade/rebuild	6,516	1,816
Support capital	1,013	313
Sub-total	<u>24,312</u>	<u>11,049</u>
Remaining reportable segments and All Other capital expenditures	<u>58,498</u>	<u>23,344</u>
	<u>\$ 82,810</u>	<u>34,393</u>

The standardized definition of a customer relationship is the number of customers that receive at least one level of service utilizing our cable services segment’s facilities, encompassing voice, video, and data

services, without regard to which services customers purchase. At September 30, 2004 and 2003 we had 122,100 and 122,400 customer relationships, respectively.

The standardized definition of a revenue generating unit is the sum of all primary analog video, digital video, high-speed data, and telephony customers, not counting additional outlets. At September 30, 2004 and 2003 we had 199,400 and 178,200 revenue generating units, respectively.

Local Access Services Segment Overview

During 2004 local access services revenues represented 10.8% of consolidated revenues.

Local Access Services Segment Revenues and Cost of Goods Sold

Local access services segment revenues increased 27.0% in 2004 to \$34.6 million primarily due to the following:

- Growth in the average number of lines in service,
- \$2.6 million increase in support from the Universal Service Program, and
- Revenues of \$1.6 million from our new phone directory distributed in December 2003.

The increase in local access services segment revenues is partially off-set by access rate decreases.

Local access services segment Cost of Goods Sold increased 21.4% to \$21.2 million in 2004 primarily due to the growth in the average number of lines in service and the increased costs resulting from the RCA's Anchorage UNE arbitration settlement order in June 2004 which increased the lease rate from \$14.92 to \$18.64 per line per month beginning on June 25, 2004.

Local Access Services Segment Operating Loss

Local access services segment operating loss decreased 45.5% to (\$3.2) million from 2003 to 2004 primarily due to the 27.0% revenue increase to \$34.6 million partially off-set by the 21.4% increase in Cost of Goods Sold to \$21.2 million, a \$513,000 increase in local services segment selling, general and administrative expenses to \$13.4 million, and a 12.1% increase in local services segment depreciation, amortization and accretion expense to \$2.9 million in 2004 as compared to 2003.

The local access services segment operating results are negatively affected by the allocation of the benefit of access cost savings to the long-distance services segment. If the local access services segment received credit for the access charge reductions recorded by the long distance services segment, the local access services segment operating loss would have improved by approximately \$5.2 million and the long distance services segment operating income would have been reduced by an equal amount in 2004. Avoided access charges totaled approximately \$5.1 million in 2003. The amount of allocated access cost savings is affected by access rate decreases from 2003 to 2004.

Internet Services Segment Overview

During 2004 Internet services segment revenues represented 6.1% of consolidated revenues.

Internet Services Segment Revenues and Cost of Goods Sold

Total Internet services segment revenues increased 37.0% to \$19.6 million in 2004 primarily due to the 28.8% increase in its allocable share of cable modem revenues to \$8.4 million in 2004 as compared to 2003. The increase in cable modem revenues is primarily due to growth in cable modem subscribers.

Internet services Cost of Goods Sold increased 21.5% to \$5.3 million in 2004 associated with increased Internet services segment revenues.

Internet Services Segment Operating Income

Internet services segment operating income increased 222.4% to \$3.7 million from 2003 to 2004 primarily due to the 37.0% increase in Internet services segment revenues to \$19.6 million in 2004 partially off-set by the 21.5% increase in Internet services segment Cost of Goods Sold to \$5.3 million in 2004, a \$677,000 increase in selling, general and administrative expenses to \$7.8 million. The increase in selling, general and administrative expenses is primarily due to an increase of approximately \$612,000 in promotion expenses in 2004 as compared to 2003.

All Other Overview

Revenues reported in the All Other category as described in note 6 in the accompanying "Notes to Interim Condensed Consolidated Financial Statements" include our managed services, product sales, and cellular telephone services.

Revenues included in the All Other category represented 9.7% of total revenues in 2004.

All Other Revenues and Cost of Goods Sold

All Other revenues increased 44.9% to \$30.8 million in 2004. The increase is primarily due to the following:

- \$6.1 million in special project revenue earned from our fiber system that transits the Trans Alaska oil pipeline corridor in 2004,
- Increased monthly revenue earned from our fiber system that transits the Trans Alaska oil pipeline corridor,
- Revenue generated from our contract to provide services to the State of Alaska starting in the first quarter of 2004, and
- Special project revenue for services sold to a certain customer.

The increase described above is partially off-set by a \$693,000 decrease in product sales revenue to \$1.6 million in 2004. The decrease is due to sales of product to two customers in 2003 that were not repeated in 2004.

All Other Cost of Goods Sold increased 52.6% to \$17.5 million in 2004. The increase in All Other Cost of Goods Sold is primarily due to the recognition of \$5.5 million in costs associated with special project revenue earned from our fiber system that transits the Trans Alaska oil pipeline corridor in 2004, costs associated with increased monthly revenue earned from our recurring service contracts in 2004, and costs associated with the special project revenue described above.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 6.1% to \$108.8 million in 2004 primarily due to a \$4.0 million increase in labor and health insurance costs, a \$2.3 million increase in contract labor and contract services expenses associated with our SOX Section 404 compliance efforts and other special projects, a \$2.1 million increase in promotion expenses in 2004 as compared to 2003, and a \$1.1 million write-off of previously capitalized mobile wireless network costs upon finalization of a long-term distribution agreement. The increases previously described are partially off-set by a \$2.8 million decrease in our company-wide success sharing bonus accrual. As a percentage of total revenues,

selling, general and administrative expenses decreased to 34.1% in 2004 from 35.7% in 2003, primarily due to an increase in revenues without a corresponding increase in selling, general and administrative expenses.

Bad Debt Expense (Recovery)

Bad debt expense decreased 160.3% to a net recovery of (\$1.2) million in 2004. The 2004 decrease is primarily due to realization of approximately \$3.4 million of the MCI credit through a reduction to bad debt expense in 2004, as further discussed in the “Long Distance Service Overview” above. We realized approximately \$647,000 of the MCI credit through a reduction to bad debt expense in 2003.

Depreciation, Amortization and Accretion Expense

Depreciation, amortization and accretion expense increased 18.8% to \$46.8 million in 2004. The increase is primarily attributed to our \$45.8 million investment in equipment and facilities placed into service during the twelve-month period ended December 31, 2003 for which a full year of depreciation will be recorded in the twelve-month period ended December 31, 2004, and the \$96.5 million investment in equipment and facilities placed into service during the nine-month period ended September 30, 2004 for which a partial year of depreciation will be recorded in the twelve-month period ended December 31, 2004.

Other Expense, Net

Other expense, net of other income, increased 2.0% to \$29.6 million in 2004. The increase is primarily due to the following:

- In 2004 we paid bond call premiums totaling \$6.1 million to redeem our old Senior Notes,
- As a result of redeeming our old Senior Notes in 2004 we recognized \$2.3 million in unamortized old Senior Notes fee expense, and
- A \$1.0 million increase in interest expense on our new Senior Notes due to an increase in the outstanding balance owed, partially off-set by a decreased interest rate in 2004 as compared to 2003.

Partially offsetting the increases described above was a \$7.1 million decrease in interest expense in 2004 on our new Senior Credit Facility due to a decrease in the average outstanding balance owed on our new Senior Credit Facility and a decreased new Senior Credit Facility interest rate as compared to 2003.

Income Tax Expense

Income tax expense was \$11.5 million in 2004 and \$9.6 million in 2003. The change was due to increased net income before income taxes and cumulative effect of a change in accounting principle in 2004 as compared to 2003. Our effective income tax rate decreased from 43.6% in 2003 to 37.8% in 2004 due to the decreasing proportion of items that are nondeductible for income tax purposes and adjustment of deferred tax assets and liabilities in 2004.

Cumulative Effect of a Change in Accounting Principle

On January 1, 2003 we adopted SFAS No. 143, “Accounting for Asset Retirement Obligations,” and recorded the cumulative effect of accretion and depreciation expense as a cumulative effect of a change in accounting principle of approximately \$544,000, net of income tax benefit of \$367,000.

Liquidity and Capital Resources

Cash flows from operating activities totaled \$62.9 million in 2004 as compared to \$49.4 million in 2003. The 2004 increase is primarily due to increased cash flow from all of our reportable segments and All Other Services, partially off-set by a \$4.3 million payment of our company-wide success sharing bonus in 2004, a \$2.7 million increase in the MCI credit recovery, as further discussed in the “Long Distance Service Overview” above, and a \$2.3 million refund in 2003 from a local exchange carrier in respect of its earnings that exceeded regulatory requirements.

Other sources of cash during 2004 include \$245.7 million from the issuance of our new Senior Notes, draws of \$20.0 million under the revolving credit portion of our new Senior Credit Facility, \$2.2 million from the issuance of our Class A common stock, and \$1.8 million in payments of notes receivable from related parties. Uses of cash during 2004 included expenditures of \$82.8 million for property and equipment, including construction in progress, the \$180.0 million repayment of our old Senior Notes, the \$53.8 million repayment of the term and revolving credit portions of our new Senior Credit Facility, payment of \$6.7 million in fees associated with the new Senior Notes and new Senior Credit Facility, payment of bond call premiums totaling \$6.1 million to redeem our old Senior Notes, and repayment of \$3.5 million in capital lease obligations.

Net receivables increased \$5.3 million from December 31, 2003 to September 30, 2004 primarily due to the timing of payments on trade receivables from certain large customers and an increase in trade receivables for broadband services provided to hospitals and health clinics. The increase in net receivables is partially off-set by the February 2004 receipt of \$5.6 million on a trade receivable for broadband services provided to hospitals and health clinics.

Working capital totaled \$26.4 million at September 30, 2004, an \$18.3 million increase as compared to \$8.1 million at December 31, 2003. The increase is primarily due to draws under the revolving credit portion of our new Senior Credit Facility in January and May 2004 totaling \$15.0 million primarily used to fund our old Senior Notes interest payment in February 2004 and to pay an accrued capital expenditure related to AULP West.

In February 2004 GCI's wholly owned subsidiary GCI, Inc. sold \$250 million in aggregate principal amount of senior unsecured debt securities due in 2014. We pay interest of 7.25% on the new Senior Notes. The new Senior Notes were sold at a discount of \$4.3 million. The Senior Notes are carried on our Consolidated Balance Sheet net of the unamortized portion of the discount, which is being amortized to Interest Expense over the life of the new Senior Notes.

The net proceeds of the offering were primarily used to repay our existing \$180.0 million 9.75% Senior Notes and to repay approximately \$43.8 million of the term portion and \$10.0 million of the revolving portion of our new Senior Credit Facility. A semi-annual interest payment of approximately \$9.1 million was paid in August 2004; the next semi-annual interest payment will be made in February 2004. In connection with the issuance, we paid fees and other expenses of approximately \$6.4 million that are being amortized over the life of the new Senior Notes.

The new Senior Notes sold in February 2004 were offered only to qualified institutional buyers pursuant to exemptions from registration under the Securities Act. On July 7, 2004, GCI, Inc. commenced an offer to exchange the privately issued new Senior Notes for a like amount of new Senior Notes that have been

registered under the Securities Act and have otherwise identical terms to the privately issued new Senior Notes (except for provisions relating to GCI, Inc.'s obligations to consummate the exchange offer). The exchange offer closing occurred on August 11, 2004, at which time all \$250.0 million in aggregate principal amount of the privately issued new Senior Notes were tendered and exchanged for the new Senior Notes that have been registered under the Securities Act.

The new Senior Notes are not redeemable prior to February 15, 2009. At any time on or after February 15, 2009, the new Senior Notes are redeemable at our option, in whole or in part, on not less than thirty days nor more than sixty days notice, at the following redemption prices, plus accrued and unpaid interest (if any) to the date of redemption:

If redeemed during the twelve month period commencing February 1 of the year indicated:	Redemption Price
2009	103.625%
2010	102.417%
2011	101.208%
2012 and thereafter	100.000%

We may, on or prior to February 17, 2007, at our option, use the net cash proceeds of one or more underwritten public offerings of our qualified stock to redeem up to a maximum of 35% of the initially outstanding aggregate principal amount of our new Senior Notes at a redemption price equal to 107.25% of the principal amount of the new Senior Notes, together with accrued and unpaid interest, if any, thereon to the date of redemption, provided that not less than 65% of the principal amount of the new Senior Notes originally issued remain outstanding following such a redemption.

The new Senior Notes restrict GCI, Inc. and certain of its subsidiaries from incurring debt in most circumstances unless the result of incurring debt does not cause our leverage ratio to exceed 6.0 to one. The new Senior Notes do not allow debt under the new Senior Credit Facility to exceed the greater of (and reduced by certain stated items):

- \$250 million, reduced by the amount of any prepayments, or
- 3.0 times earnings before interest, taxes, depreciation and amortization for the last four full fiscal quarters of GCI, Inc. and certain of its subsidiaries.

The new Senior Notes limit our ability to make cash dividend payments.

We conducted a Consent Solicitation and Tender Offer for the old Senior Notes. Through February 13, 2004 we accepted for payment \$114.6 million principal amount of notes which were validly tendered. Such notes accepted for payment received additional consideration as follows:

- \$4.0 million based upon a payment of \$1,035 per \$1,000 principal amount, consisting of the purchase price of \$1,025 per \$1,000 principal amount and the consent payment of \$10 per \$1,000 principal amount, and
- \$497,000 in accrued and unpaid interest through February 16, 2004.

The remaining principal amount of \$65.4 million was redeemed on March 18, 2004 for additional consideration as follows:

- \$2.1 million based upon a payment of \$1,032.50 per \$1,000 principal amount, and
- \$833,000 in accrued and unpaid interest through March 18, 2004.

The total redemption cost was \$186.1 million. The premium to redeem our old Senior Notes was \$6.1 million (excluding interest cost of \$1.3 million) and was recognized as a loss on early extinguishment of debt, a component of Other Income (Expense), during the nine months ended September 30, 2004.

Compliance with the redemption notice requirements in the Indenture resulted in a delay before final payment of some of the old Senior Notes. As a result of such delay, our total debt increased during the overlap period between the redemption of the old Senior Notes and the issuance of the new Senior Notes making us out of compliance with Section 6.11 of our Credit, Guaranty, Security and Pledge Agreement, dated as of October 30, 2003. We received a waiver from compliance with Section 6.11 until April 30, 2004. After the final redemption payment on March 18, 2004 we were in compliance with Section 6.11.

In 2004 we drew the following amounts under the revolving credit portion of our new Senior Credit Facility (amounts in millions):

January 2004	\$ 10.0
May 2004	5.0
August 2004	5.0
	\$ 20.0

Our ability to draw down on the revolving portion of our new Senior Credit Facility could be diminished if we are not in compliance with all new Senior Credit Facility covenants or have a material adverse change at the date of the request for the draw. In February 2004 we used a portion of the proceeds from the issuance of our new Senior Notes to repay approximately \$43.8 million of the term portion and \$10.0 million of the revolving portion of our new Senior Credit Facility.

On May 21, 2004 we amended our \$220.0 million new Senior Credit Facility. The amendment reduced the interest rate on the \$170.0 million term portion of the credit facility from LIBOR plus 3.25% to LIBOR plus 2.25%. The amendment reduced the interest rate on the \$50.0 million revolving portion of the credit facility from LIBOR plus 3.25% to LIBOR plus a margin dependent upon our Total Leverage Ratio (as defined) as follows:

Total Leverage Ratio (as defined)	LIBOR Plus:
≥3.75	2.50%
≥3.25 but <3.75	2.25%
≥2.75 but <3.25	2.00%
< 2.75	1.75%

The commitment fee we are required to pay on the unused portion of the commitment was amended as follows:

<u>Total Leverage Ratio (as defined)</u>	<u>Commitment Fee</u>
≥3.75	0.625%
≥3.25 but <3.75	0.50%
≥2.75 but <3.25	0.50%
< 2.75	0.375%

Under certain circumstances the amendment allows for an increase in the term and revolving commitments not to exceed an aggregate commitment increase of \$50.0 million. Any additional term and revolving credit facility commitments are payable in full on October 31, 2007.

In connection with the May 21, 2004 amended Senior Credit Facility, we paid bank fees and other expenses of approximately \$103,000 and \$253,000 during the three and nine months ended September 30, 2004, respectively.

We were in compliance with all loan covenants at September 30, 2004.

Our expenditures for property and equipment, including construction in progress, totaled \$82.8 million and \$34.4 million during 2004 and 2003, respectively. Our capital expenditures requirements in excess of approximately \$25 million per year, excluding the AULP West fiber optic cable system construction costs, are largely success driven and are a result of the progress we are making in the marketplace. We expect our 2004 expenditures for property and equipment for our core operations, including construction in progress and excluding the AULP West fiber optic cable system construction costs and other special projects described below, to total approximately \$65 million, depending on available opportunities and the amount of cash flow we generate during 2004.

In June 2004 we placed into service our AULP West fiber optic cable system connecting Seward, Alaska and Warrenton, Oregon, with leased backhaul facilities connecting it to our switching and distribution centers in Anchorage, Alaska and Seattle, Washington. The 1,544-statute mile cable system has a total design capacity of 960 Gigabits per second access speed. The cable complements our existing fiber optic cable system between Whittier, Alaska and Seattle, Washington. The two cables provide physically diverse backup to each other in the event of an outage. During 2004 our capital expenditures for this project have totaled approximately \$32.0 million, and from inception have totaled \$50.1 million, most of which have been funded through our operating cash flows.

Planned capital expenditures over the next five years include those necessary for continued expansion of our long-distance, local exchange and Internet facilities, supplementing our existing network backup facilities, continuing development of our Personal Communications Services (“PCS”) network, continuing deployment of DLPS, and upgrades to and expansions of our cable television plant.

In April 2004 we successfully launched our DLPS service delivery method. To ensure the necessary equipment is available to us we have entered into an agreement to purchase a certain number of outdoor, network powered multi-media adapters. The agreement has a remaining outstanding commitment at September 30, 2004 of \$15.3 million.

A migration of MCI's or Sprint's traffic off our network without it being replaced by other common carriers that interconnect with our network could have a materially adverse impact on our financial position, results of operations and liquidity.

Dividends accrued on our Series B preferred stock are payable in cash at the semi-annual payment dates of April 30 and October 31 of each year. In January 2004, 3,108 shares of our Series B preferred stock were converted to 560,000 shares of our Class A common stock at the stated conversion price of \$5.55 per share. In August 2004, 3,328 shares of our Series B preferred stock were converted to 599,640 shares of our Class A common stock at the stated conversion price of \$5.55 per share. The conversions will reduce our future semi-annual cash dividends. In April 2004 we paid a Series B preferred stock dividend of approximately \$592,000. In October 2004 we will pay a Series B preferred stock dividend of approximately \$484,000.

Dividends accrued on our Series C preferred stock are payable quarterly in cash. During the nine months ending September 30, 2004 we paid a Series C preferred stock dividend of approximately \$450,000.

GCI's board of directors has authorized the repurchase of up to \$5.0 million per quarter of our Class A and Class B common stock. We have obtained permission from our lenders and preferred shareholders for the first \$10.0 million of repurchases. During the three and nine months ended September 30, 2004 we have repurchased 28,000 shares of our Class A common stock at a cost of approximately \$252,000. We expect to continue the repurchases subject to the availability of free cash flow, credit facilities, the price of our Class A and Class B common stock and the requisite consents of lenders and preferred shareholders. The repurchase will comply with the restrictions of SEC rule 10b-18.

The long-distance, local access, cable, Internet and wireless services industries continue to experience substantial competition, regulatory uncertainty, and continuing technological changes. Our future results of operations will be affected by our ability to react to changes in the competitive and regulatory environment and by our ability to fund and implement new or enhanced technologies. We are unable to determine how competition, economic conditions, and regulatory and technological changes will affect our ability to obtain financing under acceptable terms and conditions.

We believe that we will be able to meet our current and long-term liquidity and capital requirements, fixed charges and preferred stock dividends through our cash flows from operating activities, existing cash, cash equivalents, short-term investments, credit facilities, and other external financing and equity sources. Should cash flows be insufficient to support additional borrowings and principal payments scheduled under our existing credit facilities, capital expenditures will likely be reduced.

New Accounting Standards

In March 2004, the Emerging Issues Task Force ("EITF") reached final consensus on Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share." EITF Issue No. 03-6 addresses the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating earnings per share. EITF Issue No. 03-6 is effective for fiscal periods beginning after March 31, 2004, and prior period earnings per share amounts presented for comparative purposes should be restated to conform to the

consensus guidance. We have not issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings when, and if, we declare dividends on our common stock. We do not believe EITF Issue No. 03-6 will have an effect on our EPS.

In October 2004, the FASB concluded that SFAS No. 123R, "Share-Based Payment," ("SFAS No. 123R") which would require all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, would be effective for public companies for interim or annual periods beginning after June 15, 2005. Retroactive application of the requirements of SFAS No. 123 (not SFAS No. 123R) to the beginning of the fiscal year that includes the effective date would be permitted, but not required. The FASB plans to issue a final statement on or around December 15, 2004. We are evaluating the impact of SFAS No. 123R on our results of operations, financial position, and cash flows.

In October 2004, the FASB ratified the consensus reached by the EITF with respect to EITF Issue No. 04-10, "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds," which clarifies the guidance in paragraph 19 of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." According to EITF Issue No. 04-10, operating segments that do not meet the quantitative thresholds can be aggregated only if aggregation is consistent with the objective and basic principles of SFAS No. 131, the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria listed in items (a)-(e) in paragraph 17 of SFAS No. 131. The consensus applies to fiscal years ending after October 13, 2004. We do not believe EITF 04-10 will result in a material change to our SFAS No. 131 disclosure.

Critical Accounting Policies

Our accounting and reporting policies comply with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. The financial position and results of operations can be affected by these estimates and assumptions, which are integral to understanding reported results. Critical accounting policies are those policies that management believes are the most important to the portrayal of the Company's financial condition and results, and require management to make estimates that are difficult, subjective or complex. Most accounting policies are not considered by management to be critical accounting policies. Several factors are considered in determining whether or not a policy is critical in the preparation of financial statements. These factors include, among other things, whether the estimates are significant to the financial statements, the nature of the estimates, the ability to readily validate the estimates with other information including third parties or available prices, and sensitivity of the estimates to changes in economic conditions and whether alternative accounting methods may be utilized under accounting principles generally accepted in the United States of America. For all of these policies, management cautions that future events rarely develop exactly as forecast, and the best estimates routinely require adjustment. Management has discussed the development and the selection of critical accounting policies with the Company's Audit Committee.

Those policies considered to be critical accounting policies for the nine months ended September 30, 2004 are described below.

- We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We base our estimates on the aging of our accounts

receivable balances, financial health of specific customers, and our historical write-off experience, net of recoveries. If the financial condition of our customers were to deteriorate or if they are unable to emerge from reorganization proceedings, resulting in an impairment of their ability to make payments, additional allowances may be required. If their financial condition improves or they emerge successfully from reorganization proceedings, allowances may be reduced. Such allowance changes could have a material effect on our consolidated financial condition and results of operations.

- We record all assets and liabilities acquired in purchase acquisitions, including goodwill and other intangibles, at fair value as required by SFAS No. 141, "Business Combinations." Goodwill and indefinite-lived assets such as our cable certificates are not amortized but are subject, at a minimum, to annual tests for impairment and quarterly evaluations of whether events and circumstances continue to support an indefinite useful life as required by SFAS No. 142. Other intangible assets are amortized over their estimated useful lives using the straight-line method, and are subject to impairment if events or circumstances indicate a possible inability to realize the carrying amount as required by SFAS No. 142. The initial goodwill and other intangibles recorded and subsequent impairment analysis requires management to make subjective judgments concerning estimates of the applicability of quoted market prices in active markets and, if quoted market prices are not available and/or are not applicable, how the acquired asset will perform in the future using a discounted cash flow analysis. Estimated cash flows may extend beyond ten years and, by their nature, are difficult to determine over an extended timeframe. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures and technology, and changes in discount rates, performance compared to peers, material and ongoing negative economic trends, and specific industry or market sector conditions. In determining the reasonableness of cash flow estimates, we review historical performance of the underlying asset or similar assets in an effort to improve assumptions utilized in our estimates. In assessing the fair value of goodwill and other intangibles, we may consider other information to validate the reasonableness of our valuations including third-party assessments. These evaluations could result in a change in useful lives in future periods and could result in write-down of the value of intangible assets. The SEC Staff Announcement issued on September 29, 2004 requires us to value our indefinite-lived intangible assets other than goodwill using the direct value method for impairment testing purposes no later than January 1, 2005. Our cable certificate assets are our only indefinite-lived intangible assets and were originally valued and recorded using the residual method. Because of the significance of the identified intangible assets and goodwill to our consolidated balance sheet, our annual impairment analysis pursuant to the SEC Staff Announcement and quarterly evaluation of remaining useful life will be critical. Any changes in key assumptions about the business and its prospects, changes in market conditions or other externalities, or recognition of previously unrecognized intangible assets for impairment testing purposes could result in an impairment charge and such a charge could have a material adverse effect on our consolidated results of operations. Refer to note 1(i) and note 3 in the accompanying "Notes to Interim Condensed Consolidated Financial Statements" for additional information regarding the SEC Staff Announcement and intangible assets, respectively.

- We estimate unbilled long-distance services segment Cost of Goods Sold based upon minutes of use carried through our network and established rates. We estimate unbilled costs for new circuits and services, and when network changes occur that result in traffic routing changes or a

change in carriers. Carriers that provide service to us regularly make network changes that can lead to new, revised or corrected billings. Such estimates are revised or removed when subsequent billings are received, payments are made, billing matters are researched and resolved, tariffed billing periods lapse, or when disputed charges are resolved. Revisions to previous estimates could either increase or decrease costs in the year in which the estimate is revised which could have a material effect on our consolidated financial condition and results of operations.

- Our income tax policy provides for deferred income taxes to show the effect of temporary differences between the recognition of revenue and expenses for financial and income tax reporting purposes and between the tax basis of assets and liabilities and their reported amounts in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." We have recorded deferred tax assets of approximately \$71.0 million associated with income tax net operating losses that were generated from 1990 to 2003, and that expire from 2007 to 2023. Pre-acquisition income tax net operating losses associated with acquired companies are subject to additional deductibility limits. We have recorded deferred tax assets of approximately \$2.0 million associated with alternative minimum tax credits that do not expire. Significant management judgment is required in developing our provision for income taxes, including the determination of deferred tax assets and liabilities and any valuation allowances that may be required against the deferred tax assets. In conjunction with certain 1996 acquisitions, we determined that approximately \$20 million of the acquired net operating losses would not be utilized for income tax purposes, and elected with our December 31, 1996 income tax returns to forego utilization of such acquired losses. Deferred tax assets were not recorded associated with the foregone losses and, accordingly, no valuation allowance was provided. We have not recorded a valuation allowance on the deferred tax assets as of September 30, 2004 based on management's belief that future reversals of existing taxable temporary differences and estimated future taxable income exclusive of reversing temporary differences and carryforwards, will, more likely than not, be sufficient to realize the benefit of these assets over time. In the event that actual results differ from these estimates or if our historical trends change, we may be required to record a valuation allowance on deferred tax assets, which could have a material adverse effect on our consolidated financial position, results of operations or liquidity.

Other significant accounting policies, not involving the same level of measurement uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. Policies related to revenue recognition and financial instruments require difficult judgments on complex matters that are often subject to multiple sources of authoritative guidance. Certain of these matters, including but not limited to the requirement to account for the fair value of stock options as compensation expense, are among topics currently under reexamination by accounting standards setters and regulators. With the exception of accounting for the cost of stock options, no specific conclusions reached by these standard setters appear likely to cause a material change in our accounting policies, although outcomes cannot be predicted with confidence. A complete discussion of our significant accounting policies can be found in note 1 in the "Notes to Consolidated Financial Statements" included in our December 31, 2003 annual report on Form 10-K. A condensed discussion of our significant accounting policies can be found in note 1 in the accompanying "Notes to Interim Condensed Consolidated Financial Statements."

Geographic Concentration and the Alaska Economy

We offer voice and data telecommunication and video services to customers primarily throughout Alaska. Because of this geographic concentration, growth of our business and of our operations depends upon economic conditions in Alaska. The economy of Alaska is dependent upon the natural resource industries, and in particular oil production, as well as investment earnings, tourism, government, and United States military spending. Any deterioration in these markets could have an adverse impact on us. All of the federal funding and the majority of investment revenues are dedicated for specific purposes, leaving oil revenues as the primary source of general operating revenues. In fiscal 2003 the State's actual results indicate that Alaska's oil revenues, federal funding and investment revenues supplied 36%, 30% and 21%, respectively, of the state's total revenues. In fiscal 2004 state economists forecast that Alaska's oil revenues, federal funding and investment revenues will supply 23%, 25% and 44%, respectively, of the state's total projected revenues.

The volume of oil transported by the TransAlaska Oil Pipeline System over the past 20 years has been as high as 2.0 million barrels per day in fiscal 1988. Production has been declining over the last several years with an average of 0.991 million barrels produced per day in fiscal 2003. The state forecasts the production rate to decline from 0.985 million barrels produced per day in fiscal 2004 to 0.843 million barrels produced per day in fiscal 2015.

Market prices for North Slope oil averaged \$28.15 in fiscal 2003 and are forecasted to average \$31.13 in fiscal 2004. The closing price per barrel was \$44.63 on November 3, 2004. To the extent that actual oil prices vary materially from the state's projected prices the state's projected revenues and deficits will change. When the price of oil is greater than \$23.00 per barrel, every \$1 change in the price per barrel of oil is forecasted to result in a \$40.0 to \$70.0 million change in the state's fiscal 2004 revenue. The production policy of the Organization of Petroleum Exporting Countries and its ability to continue to act in concert represents a key uncertainty in the state's revenue forecast.

The State of Alaska maintains the Constitutional Budget Reserve Fund that is intended to fund budgetary shortfalls. If the state's current projections are realized, the Constitutional Budget Reserve Fund will be depleted in 2008. The date the Constitutional Budget Reserve Fund is depleted is highly influenced by the price of oil. If the fund is depleted, aggressive state action will be necessary to increase revenues and reduce spending in order to balance the budget. The governor of the State of Alaska and the Alaska legislature continue to evaluate cost cutting and revenue enhancing measures.

Should new oil discoveries or developments not materialize or the price of oil become depressed, the long term trend of continued decline in oil production from the Prudhoe Bay area is inevitable with a corresponding adverse impact on the economy of the state, in general, and on demand for telecommunications and cable television services, and, therefore, on us, in particular. Periodically there are renewed efforts to allow exploration and development in the Arctic National Wildlife Refuge ("ANWR"). The United States Energy Information Agency estimates it could take nine years to begin oil field drilling after approval of ANWR exploration.

Deployment of a natural gas pipeline from the State of Alaska's North Slope to the Lower 48 States has been proposed to supplement natural gas supplies. A competing natural gas pipeline through Canada has also been proposed. The economic viability of a natural gas pipeline depends upon the price of and demand for natural gas. Either project could have a positive impact on the State of Alaska's revenues and could provide a substantial stimulus to the Alaska economy. In October 2004 both houses of

Congress passed and the President signed legislation allowing loan guarantees of up to \$18.0 billion, certain favorable income tax provisions and tax credits, and expedited permitting and judicial review for the construction of an Alaska natural gas pipeline. To support the construction of a natural gas pipeline, the governor of the State of Alaska has announced that he believes the state must assume some level of shipper risk, serve as an equity partner or both. The State of Alaska is actively negotiating two applications to construct a natural gas pipeline. The governor of the State of Alaska has indicated his desire to submit a contract from one or more of these groups to the Alaska legislature in January 2005.

Development of the ballistic missile defense system project may have a significant impact on Alaskan telecommunication requirements and the Alaska economy. The system is a fixed, land-based, non-nuclear missile defense system with a land and space based detection system capable of responding to limited strategic ballistic missile threats to the United States. The system includes deployment of up to 100 ground-based interceptor silos and battle management command and control facilities at Fort Greely, Alaska.

The United States Army Corps of Engineers awarded a construction contract in 2002 for test bed facilities. The contract is reported to contain basic requirements and various options that could amount to \$250 million in construction, or possibly more, if all items are executed. Construction began on the Fort Greely test bed in 2002. The first ground-based missile interceptor was placed in an underground silo on July 22, 2004. The Missile Defense Agency is reported to expect to have up to ten more interceptors emplaced by the end of 2005.

Tourism, air cargo, and service sectors have helped offset the prevailing pattern of oil industry downsizing that has occurred during much of the last several years.

We have, since our entry into the telecommunication marketplace, aggressively marketed our services to seek a larger share of the available market. The customer base in Alaska is limited, however, with a population of approximately 644,000 people. The State of Alaska's population is distributed as follows:

- 42% are located in the Municipality of Anchorage,
- 13% are located in the Fairbanks North Star Borough,
- 10% are located in the Matanuska-Susitna Borough,
- 5% are located in the City and Borough of Juneau, and
- The remaining 30% are located in other communities across the State of Alaska.

No assurance can be given that the driving forces in the Alaska economy, and in particular, oil production, will continue at appropriate levels to provide an environment for expanded economic activity.

No assurance can be given that oil companies doing business in Alaska will be successful in discovering new fields or further developing existing fields which are economic to develop and produce oil with access to the pipeline or other means of transport to market, even with a reduced level of royalties. We are not able to predict the effect of changes in the price and production volumes of North Slope oil on Alaska's economy or on us.

Seasonality

Long-distance revenues (primarily those derived from our other common carrier customers) have historically been highest in the summer months because of temporary population increases attributable

to tourism and increased seasonal economic activity such as construction, commercial fishing, and oil and gas activities. Cable television revenues are higher in the winter months because consumers spend more time at home and tend to watch more television during these months. Local access and Internet services do not exhibit significant seasonality. Our ability to implement construction projects is also hampered during the winter months because of cold temperatures, snow and short daylight hours.

Schedule of Certain Known Contractual Obligations

The following table details future projected payments associated with our certain known contractual obligations as of December 31, 2003, the date of our most recent fiscal year-end balance sheet. Our schedule of certain known contractual obligations has been updated to reflect our issuance of new Senior Notes, redemption of our old Senior Notes, and conversion of shares of Series B preferred stock to shares of GCI Class A common stock in January and August 2004.

	Payments Due by Period				
	Total	Less than 1 Year	1 to 3 Years	4 to 5 Years	More Than 5 Years
	(Amounts in thousands)				
Long-term debt	\$ 366,914	—	32,168	89,002	245,744
Interest on long-term debt	190,026	17,838	36,250	36,250	99,688
Capital lease obligations, including interest	61,902	8,448	19,201	15,775	18,478
Operating lease commitments	69,473	12,357	20,787	13,230	23,099
Redeemable preferred stock	22,659	—	10,000	—	12,659
Purchase obligations	71,038	45,024	20,303	5,711	—
Total contractual obligations	\$ 782,012	83,667	138,709	159,968	399,668

For long-term debt included in the above table, we have included principal payments on our new Senior Credit Facility and on our new Senior Notes. Interest on amounts outstanding under our new Senior Credit Facility is based on variable rates and therefore the amount is not determinable. Our old Senior Notes required semi-annual interest payments of approximately \$8.8 million through February 2004, after which they were repaid using funds from the issuance of our new Senior Notes. Our new Senior Notes require semi-annual interest payments of approximately \$9.1 million through February 2014. For a discussion of our long-term debt, including the redemption of our old Senior Notes, issuance of new Senior Notes and the use of proceeds from the issuance of new Senior Notes to pay down our new Senior Credit Facility, see note 5 to the accompanying “Notes to Interim Condensed Consolidated Financial Statements.”

For a discussion of our capital and operating leases, see note 16 to the “Notes to Consolidated Financial Statements” included in Part II of our December 31, 2003 annual report on Form 10-K.

We have included only the maturity redemption amounts on our Series B and C preferred stock (cash dividends are excluded). Our Series B preferred stock is convertible at \$5.55 per share into GCI Class A common stock. Dividends are payable in cash semi-annually at the rate of 8.5%, plus accrued but unpaid dividends. Mandatory redemption is required 12 years from the date of closing. In January and August 2004, a Series B preferred stockholder converted 3,108 and 3,328 shares of Series B preferred stock, respectively, to GCI Class A common stock. Our Series C preferred stock is convertible at \$12 per

share into GCI Class A common stock, is non-voting, and pays a 6% per annum quarterly cash dividend. We may redeem the Series C preferred stock at any time in whole but not in part. Mandatory redemption is required at any time after the fourth anniversary date at the option of holders of 80% of the outstanding shares of the Series C preferred stock. For more information about our redeemable preferred stock, see notes 1(e) and 17 to the “Notes to Consolidated Financial Statements” included in Part II of our December 31, 2003 annual report on Form 10-K.

Purchase obligations at December 31, 2003 are further described in note 16 to the “Notes to Consolidated Financial Statements” included in Part II of our December 31, 2003 annual report on Form 10-K and include the following:

- The remaining construction commitment for our fiber optic cable system of \$17.6 million,
- The remaining DLPS equipment purchase commitment of \$17.4 million, and
- The remaining \$16.0 million commitment for our Alaska Airlines agreement.

The contracts associated with these commitments are non-cancelable. Purchase obligations also include other commitments for goods and services for capital projects and normal operations which are not included in our Consolidated Balance Sheets at December 31, 2003, because the goods had not been received or the services had not been performed at December 31, 2003.

PART I.
ITEM 3.

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate changes. We do not hold derivatives for trading purposes.

Our new Senior Credit Facility carries interest rate risk. Amounts borrowed under this Agreement bear interest at Libor plus 2.25% or less depending upon our Total Leverage Ratio (as defined). Should the Libor rate change, our interest expense will increase or decrease accordingly. As of September 30, 2004, we have borrowed \$131.2 million subject to interest rate risk. On this amount, a 1% increase in the interest rate would result in \$1,312,000 in additional gross interest cost on an annualized basis. The interest rate swap agreement to convert \$25.0 million of variable interest rate debt to 3.98% fixed rate debt plus applicable margin terminated on September 21, 2004.

Our Satellite Transponder Capital Lease carries interest rate risk. Amounts borrowed under this Agreement bear interest at Libor plus 3.25%. Should the Libor rate change, our interest expense will increase or decrease accordingly. As of September 30, 2004, we have borrowed \$40.2 million subject to interest rate risk. On this amount, a 1% increase in the interest rate would result in \$402,000 in additional gross interest cost on an annualized basis.

PART I.
ITEM 4.

Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation of the effectiveness of the design and operation of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934 (“Exchange Act”) Rule 13a-15(e)) under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management to allow timely decisions regarding required disclosure.

Changes in Internal Controls

There were no changes in our internal control over financial reporting during the third quarter of 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

There were no significant changes in our internal controls or, to our knowledge, in other factors that could significantly affect our disclosure controls and procedures subsequent to the date we carried out this evaluation.

We may enhance, modify, and supplement internal controls and disclosure controls and procedures based on experience.

Sarbanes-Oxley Act of 2002 Section 404 Compliance

Section 404 of the Sarbanes Oxley Act of 2002 requires that we evaluate and report on our system of internal controls over financial reporting and have our auditor attest to such evaluation. We have prepared an internal plan of action for compliance and we are in the process of documenting, testing and remediating our system of internal controls to provide the basis for our report. Due to ongoing evaluation and testing of our internal controls and the uncertainties of the interpretation of these new requirements, we cannot assure you that there may not be significant deficiencies or material weaknesses that would be required to be reported.

**PART II.
ITEM 1.**

LEGAL PROCEEDINGS

Information regarding pending legal proceedings to which we are a party is included in note 7 to the accompanying "Notes to Interim Condensed Consolidated Financial Statements" and is incorporated herein by reference.

**PART II.
ITEM 2.**

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Not applicable.
- (b) Not applicable.
- (c) Repurchase made in the quarter ended September 30, 2004.

Issuer Purchases of Equity Securities				
Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
September 1, 2004 to September 30, 2004	28,000 (1)	\$9.03	28,000	\$9.747 million

(1) Open-market purchase.

**PART II.
ITEM 6.**

EXHIBITS

Exhibit No.	Description
31	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GENERAL COMMUNICATION, INC.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Ronald A. Duncan</u> Ronald A. Duncan	President and Director (Principal Executive Officer)	<u>November 4, 2004</u>
<u>/s/ John M. Lowber</u> John M. Lowber	Senior Vice President, Chief Financial Officer, Secretary and Treasurer (Principal Financial Officer)	<u>November 4, 2004</u>
<u>/s/ Alfred J. Walker</u> Alfred J. Walker	Vice President, Chief Accounting Officer (Principal Accounting Officer)	<u>November 4, 2004</u>